DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Assistant Secretary for Community Planning and Development

24 CFR Part 570

[Docket No. R–94–1729; FR–3474–F–02]

RIN 2506–AB53

Community Development Block Grant Program Economic Development Guidelines

AGENCY: Office of the Assistant Secretary for Community Planning and Development, HUD.

ACTION: Final rule and guidelines.

SUMMARY: This rule establishes guidelines to assist Community Development Block Grant (CDBG) recipients in evaluating and selecting economic development activities for assistance with CDBG funds. The guidelines deal with project costs and financial requirements and with the public benefit provided by such activities. This rule also makes certain other changes to facilitate the use of CDBG funds for economic development objectives.

EFFECTIVE DATE: February 6, 1995.

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SUPPLEMENTARY INFORMATION: One of the Department of Housing and Urban Development's (HUD's) expressed goals is to provide an economic lift for distressed cities. Toward this end, HUD has embarked on a course designed to make the Community Development Block Grant (CDBG) program a potentially major contributor to the provision of jobs, especially for low-income persons residing in our poorest areas. To accomplish this goal, the Department recognizes that it will need to change both the perception and the reality concerning the usefulness of CDBG for economic development objectives.

Section 806 of the Housing and Community Development Act of 1992 (the 1992 Act) requires the Secretary to establish, by regulation, guidelines to assist CDBG recipients to evaluate and select economic development activities for assistance with CDBG funds. The 1992 Act also made further changes in the CDBG program affecting the use of funds for economic development activities, particularly those carried out under the national objective of benefiting low- and moderate-income persons through the creation or retention of jobs. These changes necessitate revisions to the CDBG regulations. HUD has also determined that it is appropriate to take this opportunity to make certain other changes to the regulations to facilitate the use of CDBG funds for economic development objectives. These changes are designed to reduce the administrative burden on grantees while, at the same time, focusing efforts on assisting the residents of low- and moderate-income neighborhoods.

A proposed rule regarding these issues was published on May 31, 1994, at 59 FR 28175. The rule gave the public 30 days in which to submit comments. Fifty-one comments were received, and many of the comments were extensive. The following types and numbers of commenters were represented: 14 local government agencies, 7 state agencies, 12 national associations, 7 development organizations, 1 regional planning agency, 3 private citizens, and 7 HUD Field staff.

Applicability of This Rule to the State CDBG Program

Separate regulatory language for the Entitlement and State CDBG programs is contained in this rule. This preamble generally discusses the changes for the two programs together, with differences between the requirements for the two programs noted. Overall, such differences have been kept to a minimum.

The State CDBG program regulations do not contain an explanatory list of eligible activities, and relatively few terms are defined in regulation. The changes to §§ 570.201, 570.203, 570.204, 570.500 and 570.506 (and the accompanying preamble discussions thereof) are thus not applicable to the State CDBG program, as there are no comparable sections in the State regulations. In interpreting the list of eligible activities found in Section 105 of the Housing and Community Development Act of 1974, as amended, states may use the Entitlement regulations as interpretive guidance.

Applicability of This Rule to the HUD-Administered Small Cities and Insular Areas CDBG Programs

Portions of the Entitlement CDBG Program regulations are incorporated by reference into the regulations for the HUD-Administered Small Cities program and the Insular Areas CDBG program. Thus, the changes to the Entitlement regulations also apply to the HUD-Administered Small Cities and Insular Areas programs. Further clarification will be provided (such as through annual Notices of Funding Availability or other instructions) for those programs, particularly regarding applications proposing a limited number of activities subject to the public benefit guidelines.

Applicability of This Rule to the Indian CDBG Program

It has been determined by the Office of Native American Programs that this regulation will not be applicable to the Indian Community Development Block Grant (ICDBG) program. The nature of the ICDBG program is so separate and distinct from the Entitlement or the State and Small Cities program that it is in the best interest of the ICDBG to address these issues separately. A specific rule will be proposed at a later date to address the needs of the Indian Tribes and Alaskan Native Villages served by the ICDBG program to comply with the requirements of the Housing and Community Development Act of 1992.

Summary of Public Comments and HUD Responses

Assistance for Microenterprises

Issue. Three commenters requested that the maximum number of employees permitted in order for a business to be considered a microenterprise be increased. (2 local government agencies and 1 state agency)

Response. The term ''microenterprise'' is defined by Section 807(c)(2) of the 1992 Act as a ''commercial enterprise that has five or fewer employees, one or more of whom owns the enterprise.'' With this statutory limitation, the maximum number of employees cannot be increased.

Issue. Four commenters requested further clarification of the definition of a microenterprise. Issues raised included: whether the limitation on the number of employees applies to actual persons or full-time-equivalent positions; the scope of the term ''commercial''; and the length of time a CDBG-assisted microenterprise must remain within the five-employee maximum. (2 national associations, 1 state agency, and 1 private citizen)

Response. The Department interprets the statutory language regarding the size limitations for a microenterprise as referring to number of actual persons employed by the business, including the owner(s).

As noted above, the statutory definition of a microenterprise describes

such a business as a ''commercial enterprise. . . .'' The Department does not believe that it was Congress' intent to construe the term ''commercial'' so narrowly in this instance that it would encompass only retail businesses. Rather, the HUD interprets this term broadly to mean any ''entity engaged in commerce,'' subject to the size limitations further imposed by the statutory definition of a microenterprise. Definitions of the terms ''microenterprise'' and ''small business'' are being incorporated into the CDBG regulations at § 570.3 in this final rule.

In regard to the length of time a CDBG-assisted microenterprise must remain within these size limitations, the same general rule that applies to other CDBG activities would also apply to microenterprise assistance. That is, the size limitation applies only at the time the CDBG assistance is provided. There may often be the expectation that, in the future, the business will grow beyond five employees; that expectation should not block assistance to a currently qualified microenterprise. A grantee need not track the size of the business throughout the term of any CDBG loan received, as the commenters feared might be the case. However, it should be noted that when CDBG assistance is provided on an ongoing basis, as may often be the case for ''general support'' activities, such assistance ceases to qualify under the microenterprise eligibility category at the point when the business grows beyond the five-employee size limitation. Further assistance to the business after that time must qualify under other existing eligibility categories.

Issue. Two commenters requested that HUD further define the term ''persons developing microenterprises.'' (1 state agency and 1 private citizen)

Response. HUD agrees that it is useful to include such a definition in the regulations. Thus, a new paragraph § 570.201(o)(3) has been added to this final rule to provide such a definition. Generally, the term ''persons developing microenterprises'' is defined as persons who have expressed interest and who are, or after an initial screening process are expected to be, actively working toward developing businesses, each of which is expected to be a microenterprise at the time it is formed. It should be noted that HUD does not expect that *all* such persons will actually start a microenterprise; some ''fallout'' is expected. However, patterns of excessive ''fallout'' rates in a grantee's microenterprise activities may cause HUD to question whether such activities truly serve ''persons developing microenterprises.''

Issue. Two commenters requested that HUD revise the regulations to permit ''general support'' services to also be provided, outside of the public service cap, to businesses larger than microenterprises. (1 state agency and 1 national association)

Response. The Department cannot accommodate the requested change. Flexibility to provide such services outside the public service category is only statutorily provided for microenterprise assistance carried out under Section 105(a)(23) of the Housing and Community Development Act of 1974, as amended, and, to a less direct extent, qualified activities carried out under Section 105(a)(15) of the Act (§ 570.204 of the Entitlement regulations). As noted above, the statute also imposes the five-employee size limitation on microenterprises.

Issue. Seven commenters requested that HUD clarify various aspects of the ''general support'' portion of the microenterprise eligibility provision. Issues raised included: whether there were any circumstances in which such support activities would be considered public service activities; whether ''general support'' could be provided to employees of microenterprises who are not part-owners; whether ''general support'' included costs related to the delivery of microenterprise assistance; and whether the entities providing assistance under this category would be those most attuned to the special needs of microenterprises. (1 local government agency, 3 national associations, 2 development organizations, and 1 private citizen)

Response. As noted above, the statute limits the instances in which ''general support'' services may be provided to businesses outside the public service eligibility category. In any circumstances which fall outside the specified instances, the provision of such support services would need to qualify as public service activities.

Under the microenterprise eligibility provision, the statute limits the direct provision of ''general support'' to ''owners of microenterprises and persons developing microenterprises.'' Thus, ''general support'' cannot be provided directly to employees of microenterprises who are not part-owners. However, there may often be other ways of structuring the activity to achieve essentially the same end result. For example, financial assistance may be provided to the microenterprise owner under § 570.201(o)(1)(i) to permit the owner to provide certain benefits to his/her employees if that can be shown to assist in the ''development, stabilization, or expansion'' of the microenterprise. Alternatively, the extent of financial assistance provided to the microenterprise owner for the capital needs of the business could be sized taking into account the owner's cost of providing such benefits for his/her employees.

The term ''general support'' as it is used in the statute and § 570.201(o)(1)(iii) is not intended to specifically include the activity administrator's cost of delivering microenterprise assistance to owners of microenterprises and persons developing them. As with any CDBG activity, it is recognized that there are various necessary costs associated with carrying out a microenterprise assistance activity. As the commenters note, these may include the costs of outreach and screening, curriculum development, coordination with other agencies, formation and management of peer lending groups, and certain staff training and development. As with any other CDBG activity, such costs directly related to carrying out the microenterprise assistance activity are considered eligible as part of that activity, without being categorized as ''general support.'' Such ''activity delivery'' costs are not considered to be general administrative costs that would be subject to the 20 percent cap.

In regard to the nature of the entities carrying out activities under this eligibility category and their familiarity with the needs of microenterprises, HUD has interpreted the statutory provision as broadly as possible in developing this rule. This should permit grantees significant flexibility in determining how, and by whom, microenterprise assistance activities should be carried out, based on local needs and priorities. The specific selection of service providers is a matter of local discretion.

Issue. Four commenters recommended that some form of ''appropriate'' test be required for microenterprise assistance carried out under the new eligibility category or that the rule include some language stating that such assistance must be reasonable and necessary. (2 local government agencies, 1 state agency, and 1 HUD Field staff person)

Response. As noted in the preamble to the proposed rule, this new microenterprise eligibility category was added to the Act as a new Section 105(a)(23). This new paragraph of the statute does not contain any requirement that assistance for such activities be determined to be ''appropriate.'' In addition, this new paragraph is not included among those eligibility categories listed as covered by

the economic development ''guidelines'' to be established pursuant to the new Section 105(e) of the statute, as added by Section 806(a) of the 1992 Act. HUD does not believe that adding any regulatory requirements to this eligibility category that are not required by statute is warranted. As with any other CDBG activity, however, grantees are free to develop more restrictive local policies as they feel are appropriate to meeting their local needs and objectives. Also, pursuant to §§ 570.200(a)(5) and 570.502 of the CDBG regulations, all costs incurred for CDBG assisted activities must be in conformance with the applicable uniform administrative requirements. This includes the requirement that the costs be necessary and reasonable for the proper and efficient administration of the program. Thus, HUD does not believe it is necessary to include any special language in this regard in § 570.201(o).

Issue. A concern was raised over the fact that no revision to the Section 108 Loan Guarantee regulations at § 570.703 was proposed to reflect the addition of microenterprise assistance as a separate eligibility category. (1 HUD Field staff person)

Response. Activities eligible for assistance under the Section 108 Loan Guarantee program are specifically delineated at Section 108(a) of the Act. While the 1992 Act added the separate microenterprise eligibility category as a new Section 105(a)(23) of the statute, no reference to this new paragraph was added to Section 108(a) of the statute. Thus, this eligibility category is not directly eligible for assistance using Section 108 Loan Guarantees. However, the provision of direct assistance to microenterprises has long been, and continues to be, eligible as a special economic development activity under Section 105(a)(17) of the Act (§ 570.203(b) of the Entitlement regulations). Section 105(a)(17) is included at Section 108(a) among the list of activities eligible for Loan Guarantee assistance under that section. Therefore, grantees may use Section 108 Loan Guarantees to directly assist microenterprises, subject to the statutorily required ''appropriateness'' determination and coverage under the economic development ''guidelines'' (established in this final rule as a new § 570.209 of the Entitlement regulations and additions to § 570.482 of the State regulations). These ''guidelines'' take into account the special needs and limitations arising from the size of such businesses assisted under § 570.203(b) as required by the new Section 105(g)(1) of the statute (as added by Section 807(c)(1) of the 1992 Act).

Issue. One commenter asked whether (or how) certain assistance to in-home day care providers might be eligible under the proposed § 570.201(o) or § 570.203. The commenter noted that day care is often provided by people within their own homes. Improvements to the house may be necessary or beneficial to the provision of day care services. The existing regulations do not provide guidance as to whether improvements to a residence in this case should be classified as rehabilitation or as assistance to a business.

Response. The Department agrees that this issue is not clear in the existing regulations; the addition of the microenterprise assistance eligibility section further muddies the issue, as many home day care providers might also qualify as a microenterprise. Situations in which businesses are operated from a residence are not limited to day care provision. To address this comment, the Department has revised § 570.202 (eligible rehabilitation activities) of the Entitlement regulations. With this revision, certain situations in which physical improvements to a residence are undertaken to benefit a business operated therein may be classified as housing rehabilitation.

Ensuring That Economic Development Projects Minimize Displacement

Issue. Section 907(a) of the National Affordable Housing Act of 1990 amended Section 105(a)(17) of the statute to require, in part, that economic development projects assisted under this provision must minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods. The proposed rule implemented this provision by amending § 570.203 of the Entitlement regulations with language on displacement that was identical to that contained in the statute. Six commenters addressed this issue, and several of them recommended that further guidance be provided. However, few specific recommendations were received. (3 national associations, 1 local government agency, 1 private citizen, and 1 HUD Field staff person)

Response. HUD has determined that it is most appropriate to leave the final rule provision as proposed on this issue. Within the parameters of the statutory language, grantees will have flexibility to demonstrate compliance with this requirement as appropriate for their circumstances. One possible way in which a grantee could demonstrate compliance with this requirement is by conducting an analysis for each covered economic development project to determine that any displacement of existing businesses and jobs that is likely to occur as a result of the economic development project, both in the neighborhood in which the project is located and in other surrounding neighborhoods, is justifiable given an examination of possible alternatives.

Additional Changes to § 570.203, Special Economic Development Activities

Issue. A total of eight commenters addressed the new paragraph (c) that was proposed to be added to § 570.203 of the Entitlement regulations to specifically address items that may be considered activity delivery costs in conjunction with special economic development activities assisted under this section. The Department's principal purpose in proposing the addition of this paragraph was to permit certain job training and placement activities in direct conjunction with otherwise assisted CDBG special economic development activities to be considered part of the ''delivery cost'' of those special economic development activities. All eight commenters supported this general concept, but five of them requested modification or clarification of the provision. The recommended modifications included: extending this provision to include construction jobs created as part of CDBG projects; extending it to include all ''CDBG-eligible'' economic development projects rather than just actual ''CDBG-assisted'' projects; limiting the job training and placement activities permitted under this provision to actual low- and moderate-income persons; and reclassifying the outreach and monitoring portions of this provision as general administrative costs subject to the 20 percent cap. Clarification was also requested as to whether there were any circumstances where the job training activities discussed would still be considered a public service. (3 local government agencies, 3 national associations, and 2 development organizations)

Response. HUD has determined that it is not appropriate to extend the coverage of this provision to include job training for construction jobs created as part of all CDBG projects in general. This new economic development services provision specifically applies only to activities qualifying as special economic development activities under the CDBG program. Costs for training and apprenticeship programs directly related to the construction for these activities can generally be considered to be covered under this provision. Costs of such programs for other types of

CDBG projects can often be considered as activity delivery costs of the respective projects to which they pertain.

In regard to the comment that the proposed provision should be extended to include all ''CDBG-eligible'' economic development projects rather than just otherwise ''CDBG-assisted'' projects, the Department has determined that this recommendation has merit. Under the CDBG program, grant funds may be used to assist an activity ''in whole or in part,'' as noted at § 570.200(a) of the Entitlement regulations. There are many cases in which ''activity delivery'' costs are the only portion of an activity's overall costs that are paid for with CDBG funds. Thus, § 570.203(c) has been revised in this final rule to reflect the recommended change. In order to qualify under this provision, job training and placement activities must still constitute activity delivery costs for an economic development project that would otherwise be eligible for further assistance under § 570.203. HUD considers this to permit such training activities only where the grantee has an agreement with a specific business(es) to actually employ the person(s) trained. This provision does not authorize programs that will merely create a ''pool'' of trained persons from which a business(es) may possibly hire. (Such activities must continue to qualify as public service activities under § 570.201(e) of the Entitlement regulations unless they meet the requirements of the new § 570.201(o) or § 570.204.) It should also be noted that the use of CDBG funds for activity delivery costs qualifying under § 570.203(c) constitutes CDBG assistance to the related economic development project, regardless of the funding sources for any other portion of the project. Thus, that project becomes subject to all applicable CDBG requirements, including national objective and public benefit requirements.

In regard to the comment that the job training and placement activities permitted under this provision should be limited to actual low- and moderate-income persons, the Department has decided not to adopt this recommendation. Such a proposal confuses the distinction between eligibility and national objective requirements. As activity delivery costs, job training and placement activities carried out under § 570.203(c) are considered part of the economic development project to which they relate. Thus, they are generally considered to qualify under the same national objective as that economic development project. Such CDBG special economic development activities can qualify under a variety of national objective provisions; they are not limited to creating or retaining jobs for low- and moderate-income persons.

This comment has raised an issue, however, that HUD found to merit further consideration. Under existing regulations, with very few exceptions, the majority of persons benefiting from a CDBG-assisted activity must be low- and moderate-income persons. HUD is aware of various proposals under which certain entities have indicated a willingness to train low- and moderate-income persons for jobs and/or provide such persons with other employment opportunities, but these entities cannot agree that 51 percent of all assisted persons will be low or moderate income. HUD believes that such proposals can often provide valuable opportunities for employment of low- and moderate-income persons and that a way should be found to permit CDBG funds to assist such efforts. Thus, HUD is amending the low- and moderate-income limited clientele national objective requirements in this final rule [with a new § 570.208(a)(2)(iv) in the Entitlement regulations and a new § 570.483(b)(2)(v) in the State regulations] to authorize the use of CDBG funds for such activities that provide training and/or other employment support services in limited circumstances. This provision is discussed more fully in detail in the national objective portion of this preamble.

There also appears to be some general confusion regarding what can be considered as activity delivery costs and what must be classified as general administration subject to the 20 percent cap. Apart from the job training and placement activities discussed above, most of the remaining types of activities delineated in the proposed § 570.203(c) are already considered to be activity delivery costs eligible under the currently-existing § 570.203. The proposed new paragraph only provides a more specific statement of this point. One commenter specifically took issue with the outreach and monitoring portions of this provision, arguing that such activities should be considered part of general administration. HUD agrees that ''monitoring'' should be considered a general administration activity, and thus, that term has been deleted from the new § 570.203(c) in this final rule. However, reasonable outreach efforts by grantees to obtain applicants for available assistance and the direct management of resulting activities are routinely considered part of the delivery cost of such activities. The commenter compares the above type of outreach and marketing efforts to activities designed to help inform low-income residents about CDBG. If that reference is to activities that are designed to make residents generally aware of the CDBG program and how they may participate in determining what types of activities the community funds, such a comparison is imprecise. Rather, the type of outreach and marketing efforts included under the new § 570.203(c) would be comparable to activities designed to make residents aware of how they could apply for assistance under specific activities, such as a housing rehabilitation program.

Special Activities by Community-Based Development Organizations (CBDOs)—§ 570.204 (Section 105(a)(15) of the Act)

Issue. Six commenters addressed the eligible activities and project definition sections of the proposed rule changes at § 570.204 (a) and (b). Most of these commenters requested clarification of the proposed definitions and discussion of eligible activities. (2 national associations, 1 local government agency, 1 private individual, and 2 HUD Field staff persons)

Response. HUD has not accepted the recommendation from one national association to add language to the beginning of § 570.204(a) to specifically state that the recipient may provide CDBG funds to a subrecipient under this section ''if permitted by state or local law.'' Compliance with applicable state or local laws is a requirement for recipients in carrying out all CDBG activities; thus, there is no need to make a special statement here.

In response to the various requests for clarification of the definitions for the projects made eligible by Section 105(a)(15) of the Act, HUD has made minor changes to those definitions included in § 570.204(a) (1), (2), and (3) in this final rule. For the definition of a ''community economic development project,'' this includes a cross-reference to the Consolidated Plan rule at 24 CFR 91.1(a)(1)(iii), which describes the types of activities HUD generally considers to aid in ''expanding economic opportunities,'' which is part of the primary objective of the CDBG program as delineated at Section 101(c)(1) of the Act. The definition also notes the general conditions under which the construction or rehabilitation of housing may be included as part of a ''community economic development project.''

One commenter, a private citizen, raised a question as to whether a ''project'' qualifying under § 570.204 included only activities for which there is funding committed and which are occurring now or whether it could include proposed future activities for which no funding has yet been secured. HUD has determined that specific limits on the scope of a project cannot easily be prescribed in this regard. Thus, it has not been addressed in the text of this final rule. HUD expects recipients to use a plausible interpretation of the term ''project'' and only include activities that are to be carried out within a reasonable period of time. Such an interpretation should at least exclude activities which have not yet received necessary conceptual approvals from the local government.

HUD has also revised the reference to permitted services under § 570.204. Two commenters, a private citizen and a HUD Field staff person, requested clarification of this provision. Also, under a similar expansion of service activities as part of the new microenterprise eligibility category at § 570.201(o), one of those same commenters raised a concern about potential abuse of the expanded flexibility if the requirements were not clearly defined. HUD has reconsidered the proposed provision and has determined that it is appropriate to limit the type of services that may be excluded from the public service cap by qualifying under this section to those (1) that are specifically designed to increase economic opportunities by supporting the development of permanent jobs, or (2) services of any type carried out under this section pursuant to a strategy approved by HUD under the provisions of § 91.215(e). To reflect this change, the proposed paragraph § 570.204(a)(5) has been deleted, the proposed paragraph § 570.204(b)(2) has been renumbered to (b)(3), and a new paragraph § 570.204(b)(2) has been added to this final rule. In the State program regulations, proposed § 570.482(c)(2) has been deleted, and a new paragraph § 570.482(d) has been added to discuss the eligibility of employment-related services and microenterprise support services.

Issue. One commenter recommended that the Department consider the eligible project carried out by the qualified organization under § 570.204 to be a single eligible activity instead of ''only a loose grouping of other eligible activities.'' The commenter recommends that this approach be reflected throughout the regulations, including national objective requirements, the economic development guidelines, and record keeping requirements. (1 HUD Field staff person)

Response. In regard to eligibility requirements under § 570.204, it already is the overall project that is assessed to determine if it qualifies as one of the three types of projects authorized by this section. Problems arise when trying to apply this approach for assessing compliance with national objective requirements, economic development guidelines, and other applicable requirements, however, because of statutory requirements that must be applied to specific types of activities that may be part of the qualified project. For example, Section 105(c)(3) of the Act limits the manner in which any housing activities may be considered to benefit low- and moderate-income persons. Also, Section 105(e) of the Act, as added by Section 806(a) of the 1992 Act, subjects economic development activities to compliance with the public benefit requirements. Beyond such statutory restrictions, the Department also believes that requiring detailed information on what the organization is actually doing with the CDBG funds helps ensure accountability to both the local citizens and HUD. However, HUD has determined that the commenter's recommendation does have a certain degree of merit. Thus, HUD has made certain changes to the CDBG regulations in this final rule to ease grantees' burden in tracking national objective compliance for certain activities that may qualify for eligibility under this category. These changes are discussed further in the respective national objective portions of this preamble.

Issue. In regard to the types of entities that qualify under § 570.204, one commenter noted that such entities are commonly referred to by practitioners as ''community-based development organizations (CBDOs)'' or ''community development corporations (CDCs).'' (1 national association)

Response. HUD has determined that is appropriate, in adopting a single generic name for the entities that may qualify under § 570.204, to use a name that is commonly understood by practitioners. It was also apparent from various comments that the proposed rule's use of the term ''local development corporations (LDCs)'' in this regard caused some confusion with some commenters thinking HUD was ''picking'' one of the entities in the current rule over the others. Use of the ''CDC'' term noted by the above commenter could create confusion with existing entities funded under other Federal programs. Therefore, to reduce confusion, the term ''community-based development organization (CBDO)'' is now used in this final rule as the generic term to describe all entities that may qualify under § 570.204.

Issue. Five commenters addressed the proposed revision to the definition of the term ''subrecipient'' at § 570.500(c). The proposed revision was intended only to expand that current provision to include for-profit entities that are now specifically authorized by statute to carry out microenterprise assistance activities under the new eligibility provision implemented in this final rule by a new § 570.201(o) in the Entitlement regulations [Section 105(a)(23) of the Act]. Most of the commenters recommended that HUD not consider any entities carrying out activities under the new microenterprise category as ''subrecipients'' but rather as ''end beneficiaries.'' These commenters also requested a similar change in classification for entities receiving CDBG assistance under § 570.204 of the Entitlement regulations [Section 105(a)(15) of the Act]. Other commenters asked only for a clarification of the proposed revision to § 570.500(c). (1 local government agency, 1 development organization, and 3 HUD Field staff persons)

Response. The comments regarding entities carrying out activities under the new microenterprise category will be discussed later in this preamble in further discussion of the revision to § 570.500(c) in this final rule. This specific section will only respond to these comments as they relate to entities receiving CDBG assistance under § 570.204 of the Entitlement regulations (Section 105(a)(15) of the Act). The Department has re-examined the status of these entities within the context of the statutory language at Section 105(a)(15). This section of the statute authorizes the provision of CDBG assistance to certain qualified entities to carry out specific types of projects. Upon review, HUD has determined that the comments questioning the status of these entities as subrecipients have merit. The Department has determined that, similar to for-profit businesses carrying out economic development projects, the entities carrying out qualified activities under § 570.204 (Section 105(a)(15) of the Act) can be considered not to be an intermediary organization in the grant assistance chain acting for the grantee, but rather as being specifically eligible to receive CDBG assistance itself. While these entities are not true ''end beneficiaries'' as the commenters argue (that term applies to the persons served by the activities), they are not strictly intermediaries either. Thus, the Department has determined that such

eligible entities carrying out qualified activities under this section will no longer be considered as subrecipients under the CDBG program. In this final rule, § 570.500(c) has been amended, in part, to reflect this change.

Issue. Two commenters addressed the general jurisdictional limitations for organizations qualifying under this section as proposed at § 570.204(c)(1)(i). One of these, a national association, recommended that these regulations mirror the Community Housing Development Organization (CHDO) requirements which permit an entity to operate in a rural ''multi-county area (but not a whole state).'' The other commenter, a local government agency, recommended that the proposed regulatory language be amended to read: ''. . . *primarily* within an identified geographic area of operation *within* the jurisdiction of the recipient. . . .'' The commenter argues that this would permit an organization with a successful track record to share its experience by consulting or entering into a joint venture to support a project in other areas. (1 national association and 1 local government agency)

Response. HUD has determined not to accept the ''multi-county'' recommendation because maintaining local community control of a organization qualifying under § 570.204 is crucial. Also, it should be noted that truly rural organizations would not be subject to these regulatory restrictions anyway. This is because Section 807(f) of the 1992 Act expanded the list of organizations eligible to carry out activities in *nonentitlement* areas under Section 105(a)(15) of the Housing and Community Development Act of 1974, as amended. ''Nonprofit organizations serving the development needs of the communities of nonentitlement areas'' now qualify under Section 105(a)(15) of the Act. Since the State CDBG program regulations contain no listing of eligible activities, no regulatory language is needed to implement that change.

In regard to the second comment above regarding jurisdictional limitations, the Department agrees with the commenter's reasoning and has revised § 570.204(c)(1)(i) to reflect the recommended language in this final rule. In this regard, however, HUD does note that it interprets the term ''primarily'' as it is used in this section to mean that most of the organization's projects are located, funds are used, and staff time is expended on a project or projects within the identified geographic area of operation and that outside projects are largely incidental to the organization's activities and purposes.

Issue. One commenter recommended that HUD provide a definition for the term ''particular attention'' as it is used in the new § 570.204(c)(1)(ii) regarding addressing the needs of low- and moderate-income persons. (1 national association)

Response. The ''particular attention'' language as used in the above-noted section comes from those statutes that have been referenced for several years in the CDBG regulations at § 570.204(c)(3) defining local development corporations. The Department is not aware of any significant problems with conflicting interpretations of this language, which is the commenter's stated concern. Thus, the rule has not been modified to include a formal definition of this term. In general, HUD would expect the charter, bylaws, etc., of the CBDO to reflect a commitment to meeting the needs of low- and moderate-income persons.

Issue. In reference to the new § 570.204(c)(1)(iii), another commenter expressed ''serious reservations'' about allowing for-profit organizations to qualify under this section of the regulations. (1 development organization)

Response. The statute at Section 105(a)(15) and the CDBG regulations at § 570.204 have long permitted for-profit organizations under this section with the inclusion of Small Business Investment Companies. The rule now includes only a clearer statement of what already is permitted. The rule does provide a stipulation that any monetary profits to a CBDO's shareholders or members must be only incidental to its operations.

Issue. Four commenters addressed the board structure requirements under § 570.204(c)(1)(iv). Concerns raised included an objection to excluding organizations composed solely of institutional members from qualifying under this section and comments both for and against the inclusion of business owners in defining permitted board structures. One of the commenters also recommended that HUD permit the low- and moderate-income presumptions added by the 1992 Act to be used under this section in determining whether a sufficient percentage of board members are low- and moderate-income persons. (1 local government agency, 2 development organizations, and 1 national association)

Response. HUD has determined that all of the comments regarding the inclusion of institutions and business owners on the boards of qualifying CBDOs have some merit. Thus, the Department has refined the requirements at § 570.204(c)(1)(iv) in this final rule to permit consideration of *both* institutional board members and business owners, but only to the extent that the entities that they represent are both located in *and serve* the CBDO's geographic area of operation. In regard to the comment about permitting the presumption of low- and moderate-income residents status under this section, it is noted that the presumptions at Section 105(c)(4) of the HCD Act, as added by Section 806(e) of the 1992 Act, apply only to activities qualifying under the national objective of job creation or retention for low- and moderate-income persons. Permitting them to be used in determining compliance with the board structure requirements of this section would include too broad of a spectrum of organizations to qualify under this provision. Thus, the Department has rejected this comment.

Issue. Three commenters addressed the proposed § 570.204(c)(2) that provided further ways in which an organization might qualify as an eligible CBDO under this section. These commenters requested clarification of when this paragraph would apply, and two of the commenters specifically requested that HUD expand the jurisdictional restrictions imposed on CHDOs, as designated by the HOME program, qualifying under this paragraph. (1 national association, 1 development organization, and 1 HUD Field staff person)

Response. HUD's intent in the proposed § 570.204(c)(2) was to give organizations that did not meet the general qualification requirements of (c)(1) certain additional ways of qualifying as a CBDO under this section of the CDBG regulations. It was not intended that qualifying organizations would have to meet both (c) (1) and (2); an entity can qualify under *either* standard. HUD has revised the introductory language to § 570.204(c)(2) in this final rule to clarify that intent. An understanding of this approach is critical in assessing the requirements that a CHDO under the HOME program must meet in order to qualify under § 570.204 of the CDBG Entitlement regulations. A CHDO qualifying under the HOME program may or may not meet the general qualification requirements for a CBDO under the CDBG Entitlement program, as delineated at § 570.204(c)(1) of this final rule. If a CHDO meets those requirements, it may have an area of operation as large as the jurisdiction of the recipient, just as any other qualified CBDO. The more restrictive jurisdictional limits at § 570.204(c)(2)(iii) are only applicable to

CHDOs that cannot meet the general CDBG Entitlement qualification requirements for CBDOs. An example of such an entity would be a CHDO that meets only the minimum HOME percentage requirement for low- and moderate-income persons on its board (33 percent) and cannot show that it has sufficient types of representatives on that board to meet the 51 percent standard delineated in § 570.204(c)(1)(iv).

In assessing the comments on this issue, HUD has determined that it is appropriate to provide organizations with an additional alternative for qualifying as a CBDO under this section of the CDBG regulations. Thus, in this final rule, HUD has added a new § 570.204(c)(3) under which an organization that does not qualify under either § 570.204(c) (1) or (2) may also be determined to qualify as an eligible entity under this section if the grantee demonstrates to the satisfaction of HUD, through the provision of information regarding the organization's charter and by-laws, that the organization is sufficiently similar in purpose, function, and scope to those entities qualifying under the above-referenced paragraphs. The Department intends to have this determination made at the HUD Field Office level.

Also in this regard, it should be noted that HUD expects that many Community Development Financial Institutions meeting the criteria in Title I, Subtitle A of the Riegle Community Development and Regulatory Improvement Act of 1994 (P. L. 103–325, enacted September 23, 1994) will qualify as CBDOs under § 570.204 of the CDBG Entitlement regulations. The above-referenced subtitle comprises the Community Development Banking and Financial Institutions Act. The purpose of this subtitle is to create a Community Development Financial Institutions Fund to promote economic revitalization and community development through investment in, and assistance to, CDFIs, including enhancing the liquidity of such institutions. The CDFI Fund is to be a wholly-owned Government corporation that will not be affiliated with any other agency of the Federal Government. In this final rule, HUD is adding to the Entitlement regulations a definition of the term CDFI that references the above-noted new legislation. A CDFI is generally defined at Section 103 of that Act as an entity that (i) has a primary mission of promoting community development; (ii) serves an investment area or a targeted population; (iii) provides development services in conjunction with equity investments or loans, directly or through a subsidiary or affiliate; (iv) maintains accountability to residents of its investment area or targeted population; and (v) is not a government agency or instrumentality. An ''investment area'' is defined as an area that either (i) meets objective criteria of economic distress developed by the Fund and has significant unmet needs for loans or equity investments; or (ii) is located in a designated Empowerment Zone or Enterprise Community. These CDFI criteria are similar to those now set forth in § 570.204(c).

It should again be noted that the requirements of § 570.204 only apply to the qualification of CBDOs serving *Entitlement* jurisdictions under the CDBG program. As discussed earlier in this preamble, Section 807(f) of the 1992 Act expanded the list of organizations eligible to carry out activities in *nonentitlement* areas under Section 105(a)(15) of the HCD Act. *Any* nonprofit organization serving the development needs of nonentitlement areas now qualifies under Section 105(a)(15) of the Act for the State CDBG program.

Issue. One commenter also recommended that HUD allow a limited partnership in which the managing general partner is an eligible CBDO to qualify under § 570.204. The commenter argues that the use of low-income tax credits (LITCs) necessitates a limited partnership structure and that adding the limited partnership itself as a qualifying entity would remove the necessity of having two levels of contracts—one between the grantee and the CBDO and one between that CBDO and the limited partnership. (1 local government agency)

Response. Limited partnerships are single purpose entities which exist to syndicate and develop one project. It would be difficult to construe the definitions of the statutorily eligible entities to include limited partnerships. Thus, HUD has decided against expressly adding a provision to the regulations to include the type of limited partnership described by the commenter. However, in cases in which the activities of an LIHTC limited partnership are controlled by a § 570.204 qualified entity, usually by that entity either serving as the general partner of the limited partnership or establishing such an entity as a subsidiary, the Department has accepted that CDBG assistance may be provided by the § 570.204 qualified entity to the limited partnership for the purpose of carrying out all or part of the eligible project. The Department will continue to explore ways of removing unnecessary administrative burdens for such projects.

Issue. Specifically in regard to qualified entities in nonentitlement areas, one commenter (a state agency) took issue with the discussion of such entities contained in the preamble to the proposed rule. The state agency disagreed with HUD's statutory interpretation that the term ''nonprofit organizations serving the development needs of communities in non-entitlement areas'' excludes units of general local government. This interpretation, according to the state, would restrict the use of CDBG funds by certain State-sanctioned local entities.

Response. The Department has chosen not to accept this comment. The preamble to the proposed rule noted that a public nonprofit organization which meets Internal Revenue Service requirements for nonprofit status may qualify under Section 105(a)(15) of the Act. The Department does not define a number of terms (''neighborhood revitalization project'', ''community economic development project'', ''energy conservation project'', ''carrying out an activity'') which are significant to the discussion of CBDOs above, in order to give States maximum flexibility to implement Section 105(a)(15) within the context of their particular situations.

National Objective Standards for Low- and Moderate-Income Area Benefit Activities

Issue. A total of seven commenters addressed the proposed revisions to § 570.208(a)(1)(i) of the Entitlement regulations and § 570.483(b)(1)(i) of the State regulations dealing with activities qualifying under the national objective of benefiting low- and moderate-income persons as area benefit activities. This revision relates specifically to a proposed presumption of compliance for special economic development activities that may be carried out under § 570.203 [Sections 105(a) (14) and (17) of the HCD Act] by a community development financial institution (CDFI) meeting certain criteria. Concerns raised by the commenters included statements both for and against the proposed presumption; requests for clarification of the types of entities that would qualify as CDFIs; and requests for revisions to the ''primarily residential'' and other aspects of the regulation. (1 local government agency, 1 state agency, 1 development organization, 1 national association, 1 private citizen, and 2 HUD Field staff persons)

Response. Supporting the development and growth of CDFIs can be a critical component in the comprehensive revitalization of

distressed neighborhoods because they often address the financing needs of these areas that are otherwise unmet. Existing CDFIs have demonstrated their ability to identify and respond to community needs for equity investments, loans, and development services. Thus, HUD has decided to include a modified version of the proposed presumption in this final rule.

First, it is important to define the types of entities that may qualify as CDFIs, as some of the commenters noted. As noted earlier in this preamble, HUD is herein adding to the CDBG regulations a definition of the term CDFI that references the Title I, Subtitle A of the Riegle Community Development and Regulatory Improvement Act of 1994 (P. L. 103–325, enacted September 23, 1994). Secondly, HUD has determined that it is more appropriate to create separate paragraphs in § 570.208 of the Entitlement regulations and § 570.483 of the State regulations to reflect the options that may be used for activities carried out by certain CDFIs, rather than to simply include the proposed presumption in § 570.208(a)(1)(i) and § 570.483(b)(1). Thus, in this final rule, HUD has added new paragraphs under the ''additional criteria'' section of the national objective requirements at § 570.208(d)(6) of the Entitlement regulations and § 570.483(e)(4) of the State regulations to list the options that may be used for CDBG activities carried out by any CDFI whose charter limits its investment area to a primarily residential area consisting of at least 51 percent low- and moderate-income persons. The new paragraphs § 507.208(d)(6)(i) and § 570.483(e)(4)(i) cross reference with additional new paragraphs § 570.208(a)(1)(v) and § 570.483(b)(1)(iv) of the Entitlement and State regulations, respectively. Pursuant to these paragraphs, job creation or retention activities carried out by CDFIs meeting the above criteria may be presumed to meet the low- and moderate-income area benefit criteria. It should be noted that with the area benefit presumption applied in this manner, the ''exception criteria'' for Entitlement communities cannot be used in this regard. Thus, in order to take advantage of the area benefit presumption, the CDFI's investment area must be at least 51 percent low- and moderate-income regardless of the community's usual area benefit threshold requirement.

HUD has determined that it is also appropriate to offer a similar benefit for job creation or retention activities carried out under certain other circumstances. Thus, in this final rule, HUD has also added § 570.208(d)(5) in the Entitlement regulations, which is cross-referenced in § 570.208(a)(1)(v). Under this provision, job creation or retention activities undertaken in an area pursuant to a HUD-approved economic revitalization strategy developed in accordance with the authority of § 91.215(e) of the Consolidated Plan final rule may be presumed to meet the low- and moderate-income area benefit criteria. It should be noted that in order to reduce the potential for abuse of this provision, HUD is limiting this form of area benefit presumption to areas that are primarily residential and contain a percentage of low- and moderate-income residents that is no less than the percentage computed by HUD pursuant to § 570.208(a)(1)(ii) but in no event less than 51 percent. This means that the required low- and moderate-income percentage for the area may be significantly higher than that which the community generally uses for its area benefit activities. For those communities that generally use the ''exception criteria,'' the required low- and moderate-income percentage for this area benefit presumption is 51 percent. For a community that generally is required to meet 51 percent for regular area benefit activities, the required low- and moderate-income percentage for this area benefit presumption is that percentage level of low- and moderate-income persons in the last census block group in the community's highest quartile of block groups ranked in order of proportion of low- and moderate-income persons, as computed by HUD pursuant to § 570.208(a)(1)(ii).

The Department will develop guidelines for determining when grantees should be authorized to take advantage of the benefits of this economic revitalization strategy area approach. These guidelines will be distributed to both grantees and HUD Field Office staff.

In developing this approach for the Entitlement program, the Department became aware of significant issues concerning how the economic revitalization strategy provision might be applied to the State program. Therefore, the Department is not implementing comparable regulation language for the State program at this time. In order to gain public comment, the economic revitalization strategy area concept for states will be the subject of a future proposed rule. In the meantime, the Department welcomes any comments or suggestions on how the economic revitalization strategy area approach might be applied to the State CDBG program.

Two commenters expressed concern about the requirement in § 570.208(a)(1)(i) that limits the use of the low- and moderate-income area benefit provision in general to only those activities that serve areas that are ''primarily residential.'' It should be noted this requirement is a long-standing provision of the CDBG regulations and has served the program well. Thus, HUD has decided not to make any changes to that requirement in this final rule. One of the commenters, a HUD Field staff person, recommended that a specific exception to the ''primarily residential'' requirement be made for projects qualifying under § 570.204 of the Entitlement regulations [Section 105(a)(15) of the HCD Act] because the types of projects made eligible under that section, including ''neighborhood revitalization'' and ''community economic development,'' appear to lend themselves to an area-wide benefit test. Such a change has not been incorporated into this final rule. The activities most often carried out under § 570.204 [Section 105(a)(15)] involve the provision of housing, and Section 105(c)(3) of the HCD Act specifically precludes the use of a low- and moderate-income area benefit national objective claim for such activities. However, in recognition of the merit of the recommendation, HUD has made certain changes in this final rule to ease grantees' burden in tracking low- and moderate-income national objective compliance for housing activities in certain areas. These changes are more fully discussed later in this preamble.

One commenter, a national association, expressed support for a supposed ''revision to permit area benefit . . . without requiring that the area be defined in terms of census tracts or other official boundaries.'' The commenter appears to misunderstand current requirements. While the CDBG regulations do require entitlement grantees to use, to the greatest extent feasible, the most recently available decennial census data to support the low- and moderate-income character of the area (and § 570.208(a)(1)(iv) has been modified to incorporate a reference to the new § 570.208(a)(1)(v) in this regard), there is no current requirement that the service area be defined along census tract or other official boundaries. The language included in this regard in § 570.208(a)(1)(i) (for Entitlements) and § 570.483(b)(1) (for States) in the proposed rule is unchanged from current requirements.

National Objective Compliance by Microenterprise Assistance Activities

Issue. A total of 15 commenters addressed the proposed new § 570.208(a)(2)(iii) to be added to the Entitlement regulations and the proposed new § 570.483(b)(2)(iv) to be added to the State regulations to specifically provide the limited clientele national objective option for activities qualifying under the new microenterprise assistance eligibility category. Many of these commenters specifically supported the provision, and a few specifically opposed it. Various commenters requested revisions to or clarification of certain aspects of the provision, most of which related to the manner in which jobs created by such activities would be considered (2 local government agencies, 3 state agencies, 4 national associations, 4 development organizations, 1 private citizen, and 1 HUD Field staff person).

Response. As discussed in the preamble to the proposed rule, activities carried out under the new microenterprise eligibility category are not statutorily subject to the same low- and moderate income national objective limitations as are generally applicable to special economic development activities carried out under § 570.203 [and Sections 105(a)(14) & (17) of the HCD Act]. Thus, the low- and moderate-income limited clientele method of meeting a national objective becomes an option for activities carried out under the new microenterprise eligibility category. While many commenters specifically supported the subject proposed provision, a few commenters specifically opposed it, particularly the fact that only 51 percent of the owners of microenterprises and persons developing them would be required to be low- and moderate-income persons. Thus, there would be the potential to permit sizable numbers of non-low- and moderate-income persons to receive financial assistance to develop a for-profit business. HUD has found these arguments to be compelling. Thus, the Department has revised the subject limited clientele provision in this final rule to restrict its use to qualify only those assisted owners of microenterprises and persons developing microenterprises who are low- and moderate-income persons. This change should not be a significant issue for many of the microenterprise activities assisted under the CDBG program. Many such programs are designed to provide a means to help disadvantaged persons become more economically self-sufficient and are thus often targeted to persons who meet income qualification criteria at least as restrictive as the CDBG definition of low and moderate income. Also, to allow for some continuity of service to a low- or moderate-income person initially assisted under a microenterprise activity who later may no longer meet the income guidelines after the microenterprise actually becomes operational, the Department has retained the option that permits, for purposes of meeting this national objective requirement, any person determined to be of low or moderate income to be presumed to continue to qualify as such for up to a three-year period before that person would have to requalify. The language in this final rule also clarifies that under this new limited clientele provision, it is only owners of microenterprises and persons developing microenterprises that are considered for national objective purposes and not employees of such businesses who are not part-owners.

While the new limited clientele provision has been restricted to only low- and moderate-income persons, activities qualifying under the new microenterprise eligibility category that may serve non-low- and moderate-income entrepreneurs may still be assisted under the criteria for creation and/or retention of jobs principally for low- and moderate-income persons. Under that national objective claim, all employees of a microenterprise, including the owner(s), are considered, and a grantee can use the new presumptions added by Section 806(e) of the 1992 Act for determining a person's status as a low- or moderate-income person, as implemented in this final rule at § 570.208(a)(4) of the Entitlement regulations and § 570.483(b)(4) of the State regulations. These presumptions cannot be used under the new limited clientele provision because the 1992 Act added them as a new Section 105(c)(4) of the HCD Act which refers only to activities qualifying under the national objective of job creation or retention for low- and moderate-income persons.

One commenter asked that HUD specifically name examples of low- and moderate-income clientele. Certain such examples that apply to all activities benefiting low- and moderate-income persons are included in § 570.506(b) of the Entitlement regulations.

Two commenters requested clarification as to whether HUD's proposing the limited clientele provision for microenterprise assistance activities means that ''cost per job'' created will not be a primary consideration in the evaluation of a CDBG-funded microenterprise program. ''Cost per job'' is not a primary HUD consideration for any microenterprise assistance activities carried out under the new separate microenterprise eligibility category. Such a calculation only comes into play in the public benefit standards (established elsewhere in this final rule), which are not statutorily applicable to activities carried out under the new microenterprise eligibility category. As with any CDBG activity, however, grantees have the flexibility to add additional local criteria for activity evaluation. Also, given the general requirement that all costs charged to the CDBG program must be necessary and reasonable for the proper and efficient administration of the program, HUD expects grantees to consider cost in relation to results for all activities and to take steps to curb unusually high costs.

National Objective Compliance for Employment Support Activities

As delineated earlier in this preamble under the discussion of the new § 570.203(c) economic development services provision in the Entitlement regulations, HUD is aware of various proposals under which certain entities have indicated a willingness to train low- and moderate-income persons for jobs and/or provide such persons with other employment opportunities, but these entities cannot agree that 51 percent of all assisted persons will be low- or moderate-income. HUD believes that such proposals can often provide valuable opportunities for employment of low- and moderate-income persons and that a way should be found to permit CDBG funds to assist such efforts. Thus, HUD is amending the low- and moderate-income limited clientele national objective requirements in this final rule [with a new § 570.208(a)(2)(iv) in the Entitlement regulations and a new § 570.483(b)(2)(v) in the State regulations] to authorize the use of CDBG funds for such activities that provide training and/or other employment support services in limited circumstances. In order to qualify under this provision, CDBG assistance for the project must be limited to the provision of such training and/or supportive services; the percentage of the total project cost borne by CDBG may not exceed the percentage of all persons assisted who are low or moderate income. HUD has included this provision under the limited clientele category rather than the job creation or retention national objective category because while such use of CDBG funds solely for job training and/or supportive services can often be considered to

''involve employment'' of low- and moderate-income persons (reference Section 105(c)(1) of the Act), they cannot generally be considered to directly ''create'' or ''retain'' jobs as those terms are used in the CDBG regulations.

National Objective Standards for Low- and Moderate-Income Housing Activities

As noted under the low- and moderate-income area benefit discussion earlier in this preamble, HUD has added in this final rule new paragraphs § 570.208(d)(5) and (6) in the Entitlement regulations and § 570.483(e)(4) in the State regulations. These paragraphs lay out various national objective options for activities undertaken in certain lower-income areas either by a CDFI or (in Entitlement communities) pursuant to a HUD-approved economic revitalization strategy. Paragraph (ii) of each of these new sections refers to housing activities carried out under these circumstances, and they are cross referenced in § 570.208(a)(3) in the Entitlement regulations and § 570.483(b)(3) in the State regulations in this final rule. As noted earlier, Section 105(c)(3) of the Act limits the manner in which housing activities may be considered to benefit low- and moderate-income persons, and it precludes the use of an area benefit claim for such activities. As an alternative, the new provisions in this final rule permit all housing activities carried out under the delineated limited circumstances to be grouped together and considered as a single structure for purposes of complying with the low- and moderate-income housing national objective requirements. (For example, a grantee providing rehabilitation assistance to 10 single-family housing units in such an area could classify all 10 units as meeting the low- and moderate-income benefit national objective if at least six of the units were occupied by low- and moderate-income persons.) For the calculation of the overall low- and moderate-income benefit level of a grantee's CDBG program, such housing is still subject to the limitation on benefit to low- and moderate-income persons relative to activity costs, pursuant to § 570.200(a)(3)(iv) of the Entitlement regulations and § 570.484(b)(4) of the State regulations.

National Objective Standards for Benefiting Low- and Moderate-Income Persons Through the Creation or Retention of Jobs

Presumptions Added by 1992 Act

Issue. A total of 19 commenters addressed the general manner in which HUD proposed to implement the presumptions for determining an employee's status as a low- and moderate-income person that were added to the HCD Act as a new Section 105(c)(4) by Section 806(e) of the 1992 Act for job creation and retention activities. Of the total number of commenters, 11 clearly indicated their support for the proposed change, and five stated their opposition. Most of the support comments were based on the reduced burden and ''less intrusive'' means for determining the low- and moderate-income status of employees. Most of the comments opposing the proposed change referenced the fact that the proposed rule used only the minimum test for Empowerment Zone and Enterprise Community census tract. Concern was particularly expressed that there was no reference to the ''pervasive poverty, unemployment, and general distress'' requirement for Empowerment Zone and Enterprise Communities. (6 local government agencies, 6 national associations, 1 state agency, 3 development organizations, 2 private citizens, and 1 HUD Field staff person)

Response. After a thorough review of all of the above comments and the applicable statutory references at Title XIII, Chapter I, Subchapter C, Part I of the Omnibus Budget Reconciliation Act of 1993 regarding the eligibility criteria for Empowerment Zones and Enterprise Communities, HUD has determined that the presumptions added by the 1992 Act should be implemented in a more stringent manner than was set forth in the proposed rule. The Department particularly agrees with those commenters who noted that the ''pervasive poverty, unemployment, and general distress'' eligibility requirement for Empowerment Zone and Enterprise Communities should be reflected in the implementation of the subject low- and moderate-income presumptions for job creation and retention activities under the CDBG program. Thus, a new paragraph § 570.208(a)(4)(v) of the Entitlement regulations and a new paragraph § 570.483(b)(4)(v) of the State regulations have been added to define the requirements a census tract (or block numbering area) must meet in order to qualify for the presumptions added by the 1992 Act. Under these provisions, a census tract must, in part, demonstrate pervasive poverty and general distress by meeting at least one of three delineated standards. Two of these standards relate to the poverty levels in the various block groups comprising the census tract. The third standard provides a grantee with the option of requesting a determination from HUD that a census tract meets the ''pervasive'' test based on other objectively determinable signs of general distress. The Department intends to have the subject determinations made at the HUD Field Office level.

A conforming change to the new § 570.506(b)(7) of the Entitlement regulations regarding records that need to be maintained for the subject presumptions is also included in the final rule.

Issue. A total of 10 commenters responded to HUD's specific request for comment as to whether tighter presumption standards should be established for census tracts that comprise or include any part of a community's central business district (CBD), as discussed in the Empowerment Zone and Enterprise Community legislation. Six of the commenters wanted no special standards for CBDs. Four of the commenters argued that there must be tighter standards for such areas given the statutory eligibility criteria for Empowerment Zones and Enterprise Communities (4 local government agencies, 3 national associations, 1 development organization, and 2 private citizens).

Response. After a thorough review of all of the above comments and the applicable statutory references, HUD has determined that tighter presumption standards must be established for CBDs. The statutory arguments are compelling. Thus, in the new paragraph § 570.208(a)(4)(v) of the Entitlement regulations and a new paragraph § 570.483(b)(4)(v) of the State regulations added by this final rule, HUD has included language similar to that which appears in the Empowerment Zone and Enterprise Community regulations regarding this issue, establishing a 30 percent poverty standard for any census tract that includes any portion of a CBD (as that term is used in the most recent Census of Retail Trade).

Issue. Two commenters recommended that HUD revise the proposed rule language to include census tracts that qualify for Empowerment Zone or Enterprise Community eligibility under that program's special rules relating to the determination of poverty rates for census tracts with small populations, particularly those tracts that are more

than 75 percent zoned for commercial or industrial use (1 local government agency and 1 development organization).

Response. HUD has determined that it is not appropriate to revise the regulations implementing the CDBG presumptions to include such tracts in general. While the Empowerment Zone/Enterprise Community legislation does permit these tracts to be considered as passing the minimum poverty tests, this is done mainly in the context of qualifying the tract as part of an overall area to be designated. Because the CDBG presumptions apply only on an individual census tract basis, the Department has determined that including such tracts without limitation would unduly broaden the scope of the subject presumptions. However, it is recognized that many federally designated Empowerment Zones and Enterprise Communities could include such census tracts. Thus, the new paragraph § 570.208(a)(4)(v) of the Entitlement regulations and a new paragraph § 570.483(b)(4)(v) of the State regulations added in this final rule to implement the CDBG presumptions permit any census tract that is part of a *federally designated* Empowerment Zone or Enterprise Community to qualify for the CDBG presumption regardless of whether it meets the other general criteria delineated in the regulation.

Issue. Several commenters raised other concerns that relate to the statutory bases for the subject presumptions of a person's low- and moderate-income status for CDBG activities carried out under the national objective of job creation or retention. Issues raised included: concerns regarding the use of census tract data instead of block group or ''neighborhood'' data; a recommendation to permit communities to use data obtained through a survey; questions as to why one of the presumptions only applied to the residence of the employee while the other applied to either the employee's residence or the location of the assisted business; and concerns about the interpretation of the terms ''assisted business'' and ''job under consideration'' as used in the proposed rule, as opposed to the term ''assisted activity'' as used in the Act (4 national associations and 1 private citizen).

Response. Section 105(c)(4) of the Act, as added by Section 806(e) of the 1992 Act, which expressly authorizes the subject low- and moderate-income presumptions for job creation and retention activities, specifically refers to ''census tracts.'' Thus, overall tract data must be used in determining these presumptions. In regard to the presumption that is determined by the tract meeting what Section 105(c)(4) calls ''Federal enterprise zone eligibility criteria,'' it is noted that the Empowerment Zone/Enterprise Community legislation requires poverty rates to be determined using the most recent decennial census data available. Thus, this requirement is carried over into a new paragraph § 570.208(a)(4)(v) of the Entitlement regulations and a new paragraph § 570.483(b)(4)(v) of the State regulations added in this final rule to implement the related CDBG presumption. The other CDBG presumption, which is based on the low- and moderate-income character of the census tract in which an employee resides, does not carry with it the specific requirement that the most recent decennial census data available must be used. Thus, while HUD expects grantees to follow the general CDBG rule of using such census data to the fullest extent feasible, it would be possible for a grantee to conduct a survey to support a census tract's qualification for that presumption. However, given the statutory ''census tract'' language noted above, the area for which such a survey would be undertaken must coincide with the census tract boundary. It is further noted that this latter presumption only applies to a census tract in which an employee resides and not to the location of the assisted economic development project because of the statutory language in Section 105(c)(4).

In expressing concern over the possible interpretation of the terms ''assisted business'' and ''job under consideration,'' as used in the regulations implementing the broader presumption, one commenter gave two examples. First, the commenter states that assistance to a ''branch office'' located in a qualified tract should be able to use the presumption resulting from ''Federal enterprise zone eligibility criteria'' even if the business' principal office is located elsewhere. This is entirely consistent with the language included in the new paragraph § 570.208(a)(4)(iv) of the Entitlement regulations and the new paragraph § 570.483(b)(4)(iv) of the State regulations. In using the term ''assisted business'' in those portions of the rule, HUD does not intend to imply that the business' main office or corporate headquarters must be located in a qualified tract in order to use the presumption. The regulatory language is designed to provide sufficient restrictions to prohibit businesses from establishing only a ''shell'' office to make use of the location presumption while the actual activity being assisted is in fact being carried out elsewhere. Assistance to legitimate ''branch offices'' is not restricted under the regulatory language. As a second example, the commenter states that a ''job training center or small business assistance office'' should be able to use the presumption even though such a facility ''helps people who do not yet have businesses nor specific 'jobs under consideration'.'' It is not clear how this second example would be able to use the presumption given the statutory language at Section 105(c)(4). Based on that provision, the new presumptions can only be used for activities qualifying under the national objective of job creation or retention for low- and moderate-income persons. Job training centers or business assistance offices such as those which appear to be described in the commenter's second example generally would not qualify under that national objective and would thus not be able to use the presumption.

Issue. Two commenters raised questions about how the subject presumptions would be implemented. The first question relates to whether the presumptions based on an employee's residence could be used together with the traditional way of documenting an employee as a low- or moderate-income person in order to meet the overall 51 percent low- and moderate-income requirement for jobs created or retained by a particular assisted business. One of the commenters also asked what documentation HUD will require to verify that jobs are created when the presumption on the basis of the location of the business is used. (1 state agency and 1 private citizen)

Response. In regard to the first question, it is entirely permissible for a grantee, in a single activity, to combine counting employees presumed to be low- and moderate-income persons on the basis of their residence with those employees documented as being such persons under more traditional means. Any concerns that this could possibly lead to the company and/or the grantee being accused of ''singling out certain individuals'' for requests for income information (as one of the commenters states), is as unfounded as the ''privacy'' concerns certain persons have raised for several years in discussions of this section of the CDBG regulations. In regard to the second question, a grantee qualifying a business based on its location must still obtain sufficient documentation to demonstrate that jobs are actually created or retained by the activity. This documentation would be

similar to that which the grantee currently receives for such activities, with the exception that any employee income information would be omitted.

Issue. Two commenters recommended that the final rule contain language which would make it easy for low- and moderate-income people to challenge an ''unwarranted presumption.'' They recommend that HUD reiterate the regulatory ''substantial evidence to the contrary'' language in this section of the regulations and add wording that would encourage residents to submit challenges and direct HUD to quickly respond to such challenges. (1 national association and 1 development organization)

Response. HUD cannot accommodate this recommendation. The subject presumptions of a person's low- and moderate-income status for job creation or retention activities is specifically authorized by statute. It does not matter if the presumption appears ''unwarranted'' in a specific case; if the activity meets the requirements delineated in Section 105(c)(4) of the Act, it is entitled to use the presumption. There is a distinct difference between these presumptions and those that are HUD has otherwise established only on a regulatory basis under the limited clientele standards.

Job Creation or Retention by Public Infrastructure Improvements

The Department proposed another amendment to § 570.208(a)(4) of the CDBG Entitlement regulations and § 570.483(b)(4) of the State regulations concerning the requirements for demonstrating national objective compliance by CDBG-assisted infrastructure improvements. Eight entities commented on this proposed change: 4 states, 2 national associations, one HUD staff person and one citizen. Nearly all commenters supported HUD's efforts to provide more flexibility in this area. Several comments suggested specific revisions to HUD's proposal.

Issue. Communities often over-design public facilities to accommodate future growth; this frequently makes sense for the community. However, CDBG funds should only be used to pay costs associated with the capacity needed by presently-identified businesses, or else the grantee should track future job creation for three years.

Response. The Department has chosen not to accept this suggestion. As noted in the preamble to the proposed rule, the Department proposed shortening the three-year tracking period to one year because it has received numerous comments from states that the existing State CDBG regulations are unduly burdensome. The Department believes it would be cumbersome for HUD staff to attempt to identify and prorate construction costs associated with current vs. future capacity needs; this could place HUD staff in the role of second-guessing grantees' engineering reports.

Issue. Two commenters requested that projected, rather than actual, job creation/retention be compared to the $10,000 CDBG cost-per-job threshold. Because grantees cannot be completely certain how many jobs will actually be created, there may be instances where the projected cost per job is less than $10,000, but the actual cost per job is over $10,000.

Response. The Department concurs with these comments. The Department is concerned that grantees might intentionally overstate the projected number of jobs so as to take advantage of the less stringent requirements for projects whose per-job cost is less than $10,000. However, it is impossible for job creation or retention estimates to be 100% accurate. As the proposed regulations are worded, a grantee could be retroactively held responsible for tracking a wider universe of businesses for job creation/retention if the actual cost per job was over $10,000, even though the projected cost per job was under $10,000. In the final regulations, references to actual vs. projected job creation/retention have been eliminated. Instead, the regulations refer to jobs ''to be created or retained.''

In the regulations on public benefit documentation, the Department indicates that, where a grantee shows a pattern of substantial variation between projected and actual benefits received, a grantee will be expected to take actions to improve the accuracy of its projections. The Department has not included comparable language in this section. If, for purposes of this section, a grantee's projections show a pattern of substantial variation from actual job creation/retention, the Department will expect grantees to take steps to improve the accuracy of their projections.

Issue. One commenter recommended that, rather than requiring grantees to conduct an assessment of businesses in the service area of the public facility or improvement, the rule should require an ''appropriate'' review for public improvement projects undertaken to create or retain jobs.

Response. The Department does not accept this comment, for two reasons. This suggestion confuses requirements for meeting a national objective with requirements for demonstrating the eligibility of an activity. Equally significant is that the new statutory requirements regarding evaluating and selecting economic development projects effectively replace the ''appropriate'' determinations previously required. The Guidelines for Evaluating Project Costs and Financial Requirements are not applicable to public improvement projects; a grantee may choose to develop guidelines for evaluating public improvement projects if it wishes. The Department has chosen to apply the public Benefit standards only to those public improvement projects (undertaken to create or retain jobs) for which the projected cost per job is $10,000 or more.

Issue. HUD should restrict the use of CDBG funds in situations where economic development infrastructure activities cross privately-owned property. This would be construed as a potential windfall to the private property owner or company.

Response. The Department has chosen not to accept this recommendation. HUD is unaware of any evidence that this is a significant problem in the CDBG program. As the commenter acknowledges, states and localities have legal mechanisms to govern hookup access to public utilities.

Issue. One commenter noted that the proposed Entitlement and State regulation language differs regarding businesses with which agreements must be signed; the commenter prefers the language in the proposed State CDBG regulation.

Response. The Department has revised the relevant sections [which are now § 570.483(b)(4)(vi)(F) and § 570.208(a)(4)(vi)(F) to provide greater consistency between the two paragraphs. In revamping this section of the regulations, the Department has eliminated references to agreements with businesses.

Issue. Two states urged the Department to delete portions of the proposed regulations: the requirement for conducting an assessment of businesses in the service area of the public facility or improvement; the requirement that job creation should be tracked for each business until the business' job creation/retention obligation is fulfilled; and, where the cost per job is $10,000 or more, applying the time period for tracking businesses to just the business(es) with signed agreements for which the improvement is undertaken.

Response. Based on relevant statutory language in the Housing and Community Development Act, the Department disagrees with the implication that documentation regarding national objectives should cease once the originally-projected

number of jobs has been created. Furthermore, these recommendations would eliminate the distinction in requirements between activities in which the cost per job is $10,000 or more and those in which the cost per job is under $10,000. Based on the data from the State CDBG program, the $10,000 per job created/retained threshold appears to be significantly above the median costs for public facility/improvement projects of this sort; few projects should thus be subject to the stricter requirements. The Department believes that stricter requirements are appropriate for projects costing $10,000 per job or more, because less public benefit is being obtained per CDBG dollar expended.

However, the Department has taken seriously the underlying desire for simplicity, and as a result has worked to streamline this section of the regulations. Eliminated in the final regulations is the requirement that the recipient undertake an assessment of all businesses in the service area of the public facility/improvement to determine which businesses may create/retain jobs as a result of the public facility/improvement. Grantees are cautioned, however, that should the CDBG per-job cost of the project be $10,000 or more, the recipient must still aggregate jobs created/retained by all businesses which locate or expand in the service area of the public improvement/facility. Grantees will thus need some mechanism for identifying such businesses.

Issue. One state requested that the proposed public improvement-job creation requirements for the State program be made retroactively applicable to projects funded by states after December 9, 1992. That was the effective date of the current State CDBG regulations, in which the existing requirements concerning public improvement-job creation activities were first effected.

Response. A recent U.S. Supreme Court decision casts uncertainty on the constitutionality of retroactive rulemaking. The Department feels an attempt to provide some retroactive flexibility through the rule-making process could be legally problematic. States may, as always, request a waiver of the existing regulations for individual cases.

Other Job Creation/Retention Issues

Issue. One commenter raised a concern regarding the provision at the new § 570.208(a)(4)(vi)(B) of the Entitlement regulations which permits the aggregation of jobs for loan funds administered by a subrecipient where CDBG pays only for the staff and overhead and loans are made exclusively from non-CDBG funds. The commenter recommended that HUD change the phrase ''. . . jobs created by all the businesses receiving loans during each program year'' to ''. . . jobs projected by all the businesses receiving . . .'' This recommendation is based on the claim that during the early years of a program's operation, ''few jobs may actually have been created, even though many loans have been 'committed.' '' (1 private citizen)

Response. The commenter appears to misunderstand the subject provision. The regulation does not measure the number of jobs actually created in each program year. Instead, it measures all the jobs created as a result of the CDBG assistance by all the businesses that *receive loans* in each program year, regardless of when the jobs are actually created.

In developing this final rule, HUD has pursued additional job aggregation options in consideration of the many comments received in support of less burdensome job tracking. Also, in considering the comments on the public benefit standards, HUD has determined that it is appropriate to offer certain flexibility for activities that serve important national interests. Thus, in this final rule, HUD is delineating three additional instances under which jobs created or retained may be aggregated for purposes of determining compliance with national objective requirements. Aggregation of jobs is now also permitted for (1) activities providing technical assistance to for-profit businesses; (2) activities meeting the criteria in the public benefit standards at § 570.209(b)(2)(v) of the Entitlement regulations and § 570.482(f)(3)(v) of the State regulations; and (3) for activities carried out by a CDFI. To reflect this, § 570.208(a)(4)(vi) of the Entitlement regulations and § 570.483(b)(4)(vi) of the State regulations have been amended. In this regard, it should also be noted new paragraphs § 570.208(d)(7) and § 570.483(e)(5), added to the Entitlement and State regulations respectively, require that for an activity that may meet the standards for more than one of these options, the grantee may elect only one option under which to qualify the activity. No ''double counting'' is permitted.

Issue. One commenter raised a concern regarding the requirement regarding the criteria now at § 570.208(a)(4)(iii) and § 570.483(b)(4) making jobs ''available to'' low- and moderate-income persons, particularly the ''no special skills'' requirement unless the business agrees to hire unqualified people and then provide training. The commenters argues that HUD should not ''presume'' that low- and moderate-income persons have no education because many such persons may have a community college or vocational technical education and still be underemployed or poorly paid because of various factors. The commenter also notes that in certain cases, the jobs to be created by an assisted activity will not actually be created for a year or more, which would provide time for necessary training before the business completes its hiring process. (1 national association)

Response. The reference requirement is important to ensure that no special skill or education requirements form a barrier to low- and moderate-income persons being considered for the jobs under the ''available to'' option under § 570.208(a)(4). If a community knows that there is a pool of more skilled low- and moderate-income persons available, it can always choose to demonstrate compliance with the national objective requirement under the ''held by'' option where skill level is not considered. The new low- and moderate-income presumptions should also make it easier for grantees to use the ''held by'' option. In regard to the issue of the timing of the training versus hiring, the Department wants to ensure that any training claimed under the new ''economic development services'' provision at § 570.203(c) of the Entitlement regulations and § 570.482(d) of the State regulations is limited to persons whom the respective business has actually agreed to employ and not to include training just to provide a general ''pool'' of persons from which a business may possibly hire. This is important in distinguishing ''economic development services'' that qualify as part of the ''delivery costs'' of a related economic development project from more generic public service activities that qualify under § 570.201(e) of the Entitlement regulations. It is noted that under this final rule, activities qualifying under either of these eligibility categories can also take advantage of the new low- and moderate-income limited clientele option at § 570.208(a)(2)(iv) of the Entitlement regulations and § 570.483(b)(2)(v) of the State regulations in certain circumstances.

Request for Comment on Certain Other Job Creation/Retention Issues Not Contained in the Proposed Rule

In addition to a discussion of specific regulatory revisions, the preamble to the May 31, 1994, proposed rule also contained a specific request for public comment on certain other issues which HUD is examining in an attempt to

determine whether further changes should be proposed regarding the national objective standards for benefiting low- and moderate-income persons through the creation or retention of jobs. These issues included: (1) whether any further low- and moderate-income presumptions should be made for job creation or retention activities; (2) whether any modification should be made to the CDBG job retention requirement to document that jobs claimed as being retained would actually be lost without the CDBG assistance; and (3) whether any modification should be made to the requirement in job retention activities that, except for some allowance for jobs that may become available through turnover, the low- and moderate-income standards are applied at the time the assistance is provided, which is while the employees still have the income from the jobs that they are subject to lose. (Please refer to the preamble to the proposed rule published in the **Federal Register** on May 31, 1994, for a more complete discussion of these issues.)

A sizable amount of public comment in response to these issues was received. Many of the comments offered interesting suggestions, and HUD will be publishing an additional proposed rule in response to some of the recommendations provided. Such items must go through the proposed rulemaking process in order to provide the general public with an opportunity to comment on them before they would be published for effect. The public comments received on these issues based on the request contained in the preamble to the May 31, 1994, proposed rule will be discussed fully in the preamble to the new proposed rule.

National Objective Standards for Addressing Slums or Blight on an Area Basis

The proposed rule included a revision to § 570.208(b)(1)(ii) of the Entitlement regulations and § 570.483(c)(1)(ii) of the State regulations. This proposal would allow designated slum/blighted areas to qualify under the slum/blight national objective if the area exhibited pervasive economic disinvestment in the form of high turnover or vacancy rates in previously occupied commercial or industrial buildings.

In addition, the Department sought comment on whether instances of environmental contamination should be considered as evidence of blighting conditions. No specific regulatory language was proposed in that area, however.

The Department received valuable input on both topics relating to the slum/blight national objective. As a result, the Department has decided to propose additions to the slum/blight criteria to accommodate environmental contamination, and to revise its initially proposed criteria regarding pervasive economic disinvestment. The existing regulations would be significantly restructured to accommodate these changes.

The Department has decided to publish a new set of proposed regulations dealing with the slum/blight national objectives. The comments received by the Department on slum/blight issues will be discussed in the preamble to those new proposed regulations.

Guidelines for Evaluating and Selecting Economic Development Activities for CDBG Assistance

The proposed rule contained language implementing section 806(a) of the 1992 Act at a proposed new § 570.209 in the Entitlement regulations and additions to § 570.482 in the State regulations. The proposed regulations described guidelines for evaluating certain economic development activities assisted with CDBG funds. These guidelines consist of two parts: guidelines and objectives for evaluating project costs and financial requirements, the use of which are not mandatory, and public benefit standards, which are mandatory.

Numerous comments were received on various aspects of this section of the proposed regulations. The comments can be categorized into groups of issues, and will be discussed by category of issue.

Underwriting Guidelines—General

The proposed rule described HUD's Guidelines and Objectives for Evaluating Project Costs and Financial Requirements (the ''underwriting guidelines''); the proposed guidelines themselves were published as a separate **Federal Register** notice on the same day. Sixteen commenters commented on HUD's proposed Guidelines and Objectives for Evaluating Project Costs and Financial Requirements: 5 local governments, 4 national associations, 2 States, 3 HUD Field Office staffs, one citizen and one business development entity. Four commenters expressed overall support for the approach proposed to be taken by the Department in implementing the requirements of the 1992 Act.

Issue. Three commenters stated that the underwriting guidelines themselves should be included in the text of the regulations, rather than in a separate **Federal Register** notice. By not being part of the regulations themselves, commenters felt that the guidelines would be more easily overlooked or forgotten about in future years.

Response. These issues were carefully considered by the Department in developing the proposed rule. The rule stated that the use of the underwriting guidelines proposed at § 570.209(a) and § 570.482(e) is not mandatory. To further demonstrate this point, the specific elements of the underwriting guidelines were not included within the text of the proposed rule itself. Instead, they were proposed to be published in a concurrent but separate **Federal Register** notice. Outweighing the conmmenters' concerns is the fact that, while Congress directed that the guidelines be published by regulation, the use of the underwriting guidelines is not mandatory. To publish non-binding guidance within a set of otherwise binding regulations would be contradictory and confusing. In disseminating information on the final regulations, the Department will take steps to include the guidelines along with the final regulations, to help ensure that the **Federal Register** notice does not get overlooked.

Issue. Three widely divergent comments were received regarding the applicability of the underwriting guidelines to microenterprise and small business assistance programs. One commenter argued that ''appropriate determinations'' should not be required on a loan-by-loan basis for microenterprise activities, but could be addressed by overall program design. Another argued that the underwriting guidelines should apply to microenterprise assistance activities, so that communities will have a stronger regulatory framework upon which to develop their own guidelines for evaluating microenterprise loans. A third commenter stated that small businesses which do not qualify as microenterprises should be given some relief from the underwriting criteria and financial documentation requirements.

Response. The 1992 Act specifies that HUD is to develop guidelines for evaluating and selecting economic development activities funded under sections 105(a) (14), (15) and (17) of the Act. Microenterprise assistance activities were made separately eligible under the new § 105(a)(23) of the 1992 Act, and thus were not subjected to the underwriting guidelines by Congress. The Department feels it is inappropriate to extend coverage of the underwriting guidelines to programs which provide assistance exclusively to microenterprises and which are eligible under § 105(a)(23). Grantees may

develop their own underwriting guidelines for the evaluation of microenterprise assistance programs. However, if a grantee designs a program to provide assistance to both microenterprises and other small businesses, the public benefit standards and underwriting guidelines apply to the entire program, and grantees will be expected to evaluate each instance of assistance individually. Regarding the third comment, both the proposed and the final regulations state that different levels of review and financial documentation are appropriate for different sizes of projects and businesses; grantees are encouraged to develop guidelines which take into consideration the size of the business being assisted.

From the first of these comments, as well as from several comments addressed elsewhere in this preamble, it is clear that the relationship between the financial guidelines, the public benefit standards and the ''appropriate determination'' requirements (which the Department has heretofore relied on) is not understood. In the 1987 ''Stokvis Memo'' and in the 1992 ''Kondratas Memo'', the Department outlined its policy for implementing the statutory requirement that assistance to private for-profit entities must be ''appropriate to carry out an economic development project''. The Department believes that the new underwriting guidelines and public benefit standards, taken together, effectively comprise a methodology for determining that such assistance is appropriate, and supplant the previously-required ''appropriate determinations''.

It is important to note that the financial and public benefit standards cover a wider range of activities than did the ''appropriate determinations'', including all economic development activities funded under sections 105(a)(14) and (15) of the Act. Grantees are encouraged to develop guidelines to cover the evaluation and selection of other types of economic development activities, beyond those statutorily required. However, HUD will not evaluate or enforce locally-developed guidelines covering economic development activities other than those described in the regulations.

Issue. Three commenters expressed apprehension about a statement contained in the preamble to the proposed regulations. The Department noted that, in cases where an activity receiving CDBG financial assistance fails to meet other applicable program requirements, such as the public benefit standards or the national objective requirements, HUD will consider the extent to which the recipient conducted prudent underwriting in determining appropriate sanctions to be imposed on the recipient for such noncompliance. Commenters questioned the consistency of this statement with statutory language, felt this represented a ''gotcha'' mentality by HUD, and opened the door to HUD ''second-guessing'' grantees' underwriting decisions.

Response. Commenters are correct in noting that the Department is prohibited from basing a determination of project ineligibility on the failure of a project to meet the objectives of the underwriting guidelines. The Department will not monitor grantees' projects for compliance with HUD's underwriting guidelines. The proposed underwriting guidelines also state, however, that the Department expects that grantees will engage in some form of underwriting of projects, regardless of whether or not a grantee adopts HUD's guidelines. The intent of the preamble statement was not to suggest that HUD would ''second-guess'' local underwriting guidelines or decisions about specific projects pursuant to them. When the Department discovers cases of noncompliance with other program requirements (such as national objectives or eligibility), it has flexibility to determine the appropriate action to resolve the noncompliance. In cases of noncompliance with other program requirements, the Department reserves the right to examine whether the grantee conducted any underwriting on the activity in question. If a grantee performed no underwriting whatsoever (or purely perfunctory underwriting) on a project that fails, the Department may look to see whether even rudimentary underwriting would have disclosed to the grantee that the project was likely to fall into noncompliance. Similarly, the Department will also consider whether a grantee's underwriting disclosed that a project was likely to fail, but the grantee chose to fund the project anyway for reasons unrelated to underwriting decisions.

Issue. One HUD staff person inquired about the relationship between the public benefit standards and the underwriting guidelines. The commenter asked what HUD would do in a case where a grantee followed established underwriting guidelines, yet knowingly chose to fund a project which exceeded the public benefit standards (particularly the individual activity standards).

Response. Having complied with a grantee's underwriting standards would not recuse this project from failure to meet the regulatory requirements for public benefit. In such a situation, the Department may still consider the extent to which underwriting was performed in assessing what corrective action is appropriate to resolve the noncompliance.

Issue. One correspondent requested clarification or examples of what is meant by the statement that guidelines also apply to ''activities carried out under the authority of § 570.204 that would otherwise be eligible under § 570.203.''

Response. The Department's position is, and has been, that all activities involving assistance to a for-profit business are subject to the same requirements (including the underwriting guidelines, the public benefit standards, and the previously-required ''appropriate determinations''). Provision of CDBG assistance to a for-profit business through a non-profit subrecipient does not exempt such an activity from the underwriting guidelines or public benefit standards. In the final regulations, this principle is clarified and illustrated with an example.

Issue. Three commenters raised questions about the treatment of non-financial or indirect assistance to businesses in the underwriting guidelines. Two commenters felt that by not specifically addressing the level of underwriting documentation needed for technical assistance activities, the proposed regulations imply that the same degree of analysis is required for technical assistance to a business as for direct financial assistance. Two commenters also urged the department to accept yearly aggregation of technical assistance activities for demonstrating compliance with national objectives.

Response. The Department concurs with the comments regarding technical assistance activities. The underwriting guidelines published today specifically mention that different levels of underwriting documentation may be appropriate for technical assistance activities, given the nature and dollar value of assistance being provided to businesses. The Department has also added a provision to the national objectives requirements for low- and moderate-income benefit, to allow job creation/retention to be aggregated for technical assistance activities.

Certain indirect forms of assistance to business, such as land acquisition or certain public improvement projects, are not statutorily subject to the underwriting guidelines. The Department believes that, while not mandatory, grantees should evaluate all forms of assistance to businesses, to ensure that the project represents an appropriate use of the grantee's funds. Grantees are encouraged to develop

underwriting guidelines which include other economic development activities beyond those subject to the regulations.

Issue. Several comments were received on the wording of several of the objectives in the guidelines. These comments generally spring from the commenters' professional opinions on the desirable design features or outcomes of individual programs.

Response. Because the underwriting guidelines are not mandatory, the Department has chosen not to adopt most of these suggestions. Commenters are encouraged to incorporate their ideas into their local guidelines.

Public Benefit Standards

HUD heard from 20 different commenters on the public benefit standards (and how they would be applied) in the proposed regulations: 3 local governments, 2 states, 8 national associations, 2 development organizations, one citizen and 4 HUD staff. Comments on public benefit fell into four categories of concern: the overall approach and terminology used; the individual activity standards; activities providing insufficient public benefit; and the aggregate standards. While numerous questions and concerns were raised, individual commenters also expressed general support for various aspects of the proposed approach to public benefit: the concept of aggregating public benefit; the flexibility provided by multiple approaches to measuring public benefit; and the concept of allowing certain categories of activities to be excluded from the aggregate dollar standards.

It was also very clear that many commenters did not understand the relationship among the different public benefit standards. Confusion was also expressed about the meaning of various terms used in the proposed regulations, which apparently added to confusion over the relationships among the standards. To overcome this confusion, the Department has substantially rewritten and reorganized the final regulations sections on public benefit.

Overall Approach and Terminology

Issue. Three different commenters asked for clarification of various terms such as ''tests'', ''criteria'', ''portfolio'' and ''obligated''. One asked what constituted an ''activity'' for purposes of aggregation: an individual loan? All activity in one particular loan program run by a grantee? Would a grantee with 10 different programs subject to the public benefit standards develop 10 aggregate numbers, or one? Another asked for confirmation that the public benefit measurement period differs from the time period in which job creation/retention is measured for national objectives documentation.

Response. In the final regulation, the Department has attempted to use more precise wording. The term ''obligated'' here has the same meaning as it does elsewhere in the CDBG program—a formal commitment of funds to fund a specific activity, such as a signed contract with a business, or written notification of loan approval. The term ''test'' has been replaced with ''standard''; each numerical measure by which activities are judged (individually or in aggregate) is a standard. Use of the term ''portfolio'' has been avoided in discussing the aggregate standards. Use of the term ''criteria'' is limited to describing the ''important national interests'' activities which may be excluded from the aggregate standards.

The comment regarding the measurement period for public benefit vs. national objectives is correct. For most covered activities designed to create/retain jobs, each provision of assistance to a business is judged separately for whether it meets a national objective; each business is discretely tracked for job creation/retention until the business has fulfilled its jobs commitment. In contrast, public benefit for any given business is judged at the time assistance is first obligated to the business; the levels of public benefit determined at the time funds are obligated are then aggregated for all instances of assistance provided by a grantee through all covered activities. (The period of time over which activities are aggregated varies among the Entitlement, State, Insular and HUD-Administered CDBG programs.) Thus, for any given business, job creation/retention is primarily measured prospectively for public benefit and retrospectively for national objectives purposes. (However, this explanation does not apply universally; as the regulations note, certain types of activities may be aggregated differently. In addition, grantees are to keep comparative documentation on the projected vs. actual public benefit from projects.)

Issue. A number of commenters voiced various objections to the overall approach to public benefit: the proposed standards are arbitrary and simplistic, and invite ''second-guessing'' of projects by HUD; more study is needed in this area before specific standards are proposed; the standards focus too much on the cost per job and assume that more jobs per CDBG dollar is a more important outcome than job quality; the standards ignore present or future values of assistance provided; the standards focus too much on individual activities, ignoring overall program outcomes; the standards focus too much on aggregate benefits, ignoring individual activities.

Response. As discussed in the preamble to the proposed regulations, the Department considered all of these issues in developing the proposed public benefit standards. More sophisticated measurement systems involve greater complexity, and may increase the documentation burden on grantees and/or reduce flexibility. The Department strives to effect a system which is flexible enough to encompass the great variety of individual programs and individual activities which exist across the CDBG program, and yet ensures at least some modicum of public benefit will be obtained from any given activity. The Department has made revisions to the public benefit standards in response to comments, but has chosen not to radically change the overall approach.

Issue. Two commenters (including one state) suggested that each community (or the state) be allowed to establish its own public benefit standards; HUD could then monitor communities or states for compliance with their standards.

Response. The Department believes these suggestions are inconsistent with the statute. The 1992 Act specified that HUD is to develop, by regulation, guidelines to ensure that public benefit is appropriate relative to the amount of CDBG assistance provided. The commenters' approach could increase, not decrease, grantee complaints about HUD ''second guessing'' local decisions.

Individual Activity Standards

Issue. Five commenters opined that the proposed $100,000-per-job individual activity standard is much too high to ensure reasonable public benefit for any given activity; various figures between $12,000 and $50,000 were suggested as replacements. On the other hand, one commenter expressed concern that the $100,000 standard could preclude use of CDBG funds for massive real estate redevelopment projects or capital-intensive industrial projects; other public benefits from such projects may well justify the expenditure of CDBG funds even when the cost per job is high.

Response. After weighing these arguments, the Department has decided to lower the individual activity per-job standard to $50,000. This should still provide flexibility to undertake vitally important projects with high capital costs per job created or retained;

grantees may request a waiver of regulations for projects which would exceed this level. The ''CDBG cost per job'' and the ''CDBG cost per low- and moderate-income person served'' standards are designed to establish absolute upper limits for what HUD would consider to be reasonable on an individual project basis. Grantees are free to set lower per-job maximums for their own projects, if they wish.

Another example of high-cost projects which the Department has become aware of is the removal of environmental contaminants as part of a redevelopment project. The use of CDBG funds for such ''brownfields remediation'' activities is of growing interest among grantees. Projects of this nature can present high costs relative to the amount of public benefit as defined in these regulations. However, grantees may have additional flexibility in structuring the use of CDBG funds to treat environmental conditions. For example, publicly-owned land may be cleaned up before title is transferred to a private owner. In this way, the environmental remediation activity would not be subject to the public benefit standards.

Issue. Two commenters opined that the proposed $1,000 per area-resident standard is similarly too high to ensure reasonable public benefit; one recommended $50 instead.

Response. The Department has decided to leave the per-area-resident standard as proposed. A lower figure could hinder economic development activities in small communities or sparsely-populated rural areas. Grantees are free to set lower per-area-resident maximums for their own projects, if they wish.

''Insufficient Public Benefit'' Activities

The proposed regulations contained a list of activities for which HUD believes insufficient public benefit is derived; these activities would therefore not be eligible for CDBG assistance. Six comments were received on this list of activities (one each from a citizen, a local government, a national association and a HUD staff person, and two from states). Three commenters suggested additional activities to be added to the list of activities, two commenters objected to the inclusion of one activity on the list, and two commenters requested clarification of language.

Issue. Use of grant funds for projects that will directly compete with existing businesses should be prohibited.

Response. The Department believes this proposal would severely restrict grantees' use of CDBG funds for economic development and would handcuff the Department's efforts to make CDBG a more flexible funding resource. There is nothing which would prevent individual grantees from adopting such a policy, if they wish.

Issue. Gaming facilities (whether on or off Indian Reservations) should also be made ineligible.

Response. The Department has considered this issue in the past and has decided not to pursue it.

Issue. Job Pirating (the use of CDBG funds to move a business from one community to another, with no net expansion of activity) is a waste of taxpayers' money and should be determined to be an ineligible activity.

Response. The Department has studied the problem of job piracy a number of times in the past, but has not taken action to prohibit this activity. Determining whether a business is relocating principally because of the CDBG assistance, or because of other reasons, is a particularly intractable problem in attempting to define job piracy. Recently, Congress has shown interest in legislating on this issue. The Department has therefore decided to defer action on the issue of job piracy until it is clear what action might be taken in authorizing legislation.

Issue. Three commenters opposed including the acquisition of land for which no specific use has been determined on the list of ''insufficient public benefit'' activities. Commenters argued that this would eliminate future economic development activities, and that forcing grantees to prematurely identify the use of land drives up the development cost. One commenter suggested that HUD require land acquisition to meet a national objective within two years of the expenditure of funds.

Response. The Department does not find the arguments for removing this activity from the list to be convincing. The Department is aware of a number of situations in which land has been purchased using CDBG funds with no specific use in mind, and in which the Department later determined that no national objective was ever met by the acquisition. In the Department's opinion, ''landbanking'' with CDBG funds does not provide any public benefit. It should be noted that the proposed regulation would not prohibit the construction of speculative buildings for which no tenant has been identified; nor does it mean that a specific occupant must be identified before land can be purchased. However, a grantee should at least be able to identify the intended use of the property (such as for a shopping center or office building). That does not mean, however, that grantees could satisfy the regulatory intent simply by identifying just any vaguely described proposed use. The language has been revised slightly in the final regulations to refer to ''acquisition of land for which the specific use has not been identified''.

Issue. One commenter requested specific examples of types of privately-owned recreational facilities serving a predominantly-higher income clientele which might be determined ineligible under the proposed regulations. Concerning another activity on the list, this commenter also noted that the proposed language would not prevent the provision of assistance to a ''corporate shell'' or another corporate entity established by the same owner(s) of a business which is the subject of unresolved findings.

Response. The Department has chosen not to try to develop such a list of recreational facilities, as that list might be misinterpreted as all-encompassing; furthermore, a comparison of the recreational benefits vs. other benefit to low- and moderate-income persons must of necessity be done on a case-by-case basis. The Department concurs with the second comment; the final regulations have been revised to include other businesses owned by the same owner(s). The final rule also makes minor clarifying revisions to several of the other ''insufficient public benefit'' activities.

Aggregate Activity Standards

Issue. Three commenters argued that the aggregate standards are too complex, and so should be eliminated. Some commenters feared that grantees may focus only on the individual activity standards and overlook the aggregate standards; the human tendency will be to fund high-profile, high-cost-per-benefit projects first and ''make it up later'' with smaller projects. Another commenter expressed concern that for low-volume economic development programs, the individual and aggregate standards would effectively be the same; if a grantee does one loan early in a year with a per-job cost over $35,000 and then ends up making no other loans, the grantee automatically fails the aggregate standard.

Response. To reinforce the significance of the aggregate public standards, the regulations concerning public benefit have been re-ordered to discuss the aggregate standards first. It is not the Department's intent to unduly penalize low-volume economic development programs for noncompliance by one or two loans. However, in evaluating projects for possible funding, all grantees are well

advised to consider their historical levels of economic development activity to ensure that the aggregate standards will be met. It should be noted that HUD's decision to lower the individual activity standard for job creation/retention from $100,000 to $50,000 should reduce the possibility that grantees will fail the aggregate standard because they funded very high cost-per-job projects early in the year.

Issue. One commenter argued that the $35,000 per-job aggregate standard is too high to ensure reasonable public benefit; several alternative standards in the range of $5,000–$10,000 per job were recommended instead.

Response. The Department has chosen not to accept this recommendation. This commenter also raised other objections to HUD's proposed method for assessing public benefit; taken together, their comments argue for a much more rigorous approach to economic development funding, which would reduce grantee flexibility.

Issue. One commenter argued in favor of either eliminating the $350 per low- and moderate-income area resident standard, or at least raising it to $500.

Response. The Department has decided to retain the proposed $350 figure.

Issue. One HUD staff person questioned how public benefit would be measured in the aggregate under the HUD-Administered Small Cities CDBG program, given that many grantees have revolving loan funds funded with program income from previous grants.

Response. The Department agrees that the proposed regulations do not adequately address this issue. In the final Entitlement regulations, § 570.209(b)(2) has been revised to address aggregate public benefit in the HUD-Administered Small Cities and Insular Areas CDBG programs.

Issue. Four comments were received on the list of ''important national interest'' activities. Two commenters felt that more than 75% of a grantee's funds should be used for such ''important national interest'' activities in order to meet the alternate aggregate standard. One commenter felt the criteria were so broadly written as to allow virtually all activities to qualify, and particularly objected to four of the proposed criteria [(E), (F), (H), (L)] as inappropriate. Another questioned why microenterprise assistance activities [(G)] were included on the list, when microenterprise assistance activities funded under § 105(a)(23) of the Act are not subject to the public benefit standards. One commenter favored keeping the percentage of funds requirement at 75%.

Response. In developing final regulations, the Department has substantially revised the concept that certain activities can be excluded from the $35,000 per-job or $350 per-area-resident aggregate standards. The 75% provision has been eliminated as an alternate to the aggregate dollar standards. Instead, grantees may, at their option, exclude individual ''important national interest'' activities from the aggregate standards. The list of ''important national interest'' activities which can be excluded from the aggregate standards has also been revised. Proposed criterion (G) has been eliminated, and proposed criteria (A) and (B) have been combined. Two new criteria [(L) and (M)] have been added to the Entitlement program final rule; these criteria provide additional flexibility in support of the new ''economic revitalization strategy area'' approach to demonstrating national objectives compliance. (This approach is discussed under ''Low and Moderate Income Area Benefit Activities'' above; as noted there, the approach is being implemented in the Entitlement program only at this time.) The remaining criteria are now more narrowly defined to better target assistance to certain population groups. One significant effect of these changes to the ''important national interest'' activities is worth noting. All activities which do not meet one of these ''important national interest'' criteria must be subject to the aggregate dollar standards.

Issue. Two commenters expressed concern about the relationship of the aggregate standards to the Section 108 Loan Guarantee Program. Concern is expressed that the $35,000 per-job aggregate standard will hinder grantees' use of the Section 108 Loan Guarantee program; Section 108 projects are often big projects which could overwhelm the aggregate average. If an expenditure of CDBG funds is required several years down the line to cover a default, the grantee's aggregate level of public benefit would suddenly become skewed too late for a grantee to make adjustments.

Response. It is acknowledged that certain large Section 108 projects might have a high cost per job; however, the Department believes Section 108 projects should be treated consistently with other CDBG-funded projects. The Department has revised the requirements applying to the ''important national interests'' activities listed in the final rule; grantees may now, at their option, exclude activities meeting these criteria from the aggregate standards. The Department believes many Section 108 projects could meet one or more of these criteria. Grantees may also request a waiver of the regulations for individual activities which may not meet the public benefit requirements. Concerning an unexpected skewing of aggregate benefit resulting from a default, grantees should consider the possibility of a default when deciding whether to fund proposed projects.

Issue. One commenter suggested that economic development services activities funded under proposed § 570.203(c) of the Entitlement regulations be excluded from the public benefit standards, either categorically or at the grantee's option.

Response. The Department does not believe it possible to exempt this type of economic development activity from the public benefit standards, given the statutory language mandating the development of public benefit standards for activities qualifying under this authority.

The Department has added language to the discussion of public benefit which clarifies how to apply the individual and aggregate standards to activities which provide job training, job placement and other employment support services. Except for microenterprise assistance activities eligible under § 105(a)(23) of the Act, many such activities will be subject to the public benefit standards because they are undertaken pursuant to Sections 105(a)(14), (15) or (17) of the Act. For purposes of the individual and aggregate public benefit standards only, the jobs which such services involve are counted as jobs created or retained. (See also the preamble discussion of national objectives for further information on these activities.)

Public Benefit Standards—Documentation of Benefit

Five commenters (two states and three national associations) offered comments on proposed paragraphs 570.209(d) and 570.482(e)(6). Comments fell into two groups: those concerned about what constitutes a substantial difference in actual versus projected benefits; and those concerned about what sanctions the Department might take where actual benefits were found to be substantially less than projected benefits. One of the comments expressed general support for the approach to allow adjustment to the projection process.

Issue. One commenter felt that if a grantee re-evaluates an amended project, it should be held accountable to its amended projections, not to its initial projections. The commenter recommended that the regulations

should refer to ''initial or amended projections''.

Response. The Department concurs with this point; the final regulations discuss benefits in terms of benefits ''anticipated when the CDBG assistance was obligated.'' This is intended to include situations in which projections are revised because of changes in a project which a grantee agrees to allow.

Issue. One commenter recommended that grantees' records concerning the amount of public benefit derived from projects be made available to the public at no cost. This commenter also recommended that Entitlement grantees' Grantee Performance Reports should contain information on differences between projected and actual public benefits from projects.

Response. Existing requirement concerning the availability of documents to the public (such as the CDBG citizen participation requirements) already cover the commenter's first concern. The Department will take under advisement the suggestion concerning reporting of benefits, at such time in the future that reporting requirements are revised.

Issue. One commenter expressed the opinion that if a grantee shows a pattern of substantial differences between projected and actual benefits, over perhaps a two year period, HUD should impose a two-year moratorium on the offending activity for that grantee.

Response. The Department does not accept this recommendation, as it is inconsistent with existing CDBG regulations concerning sanctions for noncompliance. The Department opposes the concept of developing different, prescribed sanctions for different categories of noncompliance.

Issue. One commenter expressed concern over the proposal that the Department might hold a grantee to more stringent public benefit standards in the future when the Department found a grantee to have failed the public benefit standards. The commenter recommended that the Department not take such action unless a grantee failed the standards for two consecutive years, so as not to punish a grantee which might do only one project in a year and have that one project prove unsuccessful.

Response. While the Department agrees that low-volume economic development programs should not be unduly penalized for the failure of one project, the Department considers it inappropriate to identify a specific time period over which to measure success or failure. The final regulations have been revised to discuss situations in which ''a pattern of substantial variation'' occurs.

Issue. Two states expressed concern about proposed language requiring a state to ''take all actions reasonably within its control'' to improve a unit of local government's public benefit projections, when actual results vary substantially from initial projections. This language was seen as imprecise, and calls into question just what actions are within a state's (versus the local government's) control to rectify the problem. One state expressed concern that HUD might sanction a state even after the state took all actions available to it to correct a problem. The other state, while recognizing HUD's oversight role, felt it inappropriate for HUD to second-guess a state's actions, as only the state can impose on itself those actions necessary to resolve the problem at the local level.

Response. These comments, as well as those discussed previously, clearly indicate concern by grantees over what sanctions the Department might take against a grantee, and over what local-level actions are ''enough'' to address a problem. The Department concurs up to a point with the states' comments. The intended meaning of this paragraph was that if local governments' results disclose a pattern of inaccurately projecting pubic benefits, then the state should take actions to insure that localities improve projection accuracy; if a state were to do little or nothing to correct the problems, then HUD could impose stricter standards upon a state. Similarly, if an Entitlement grantee demonstrates that its projection process is inaccurate, it should take steps to improve the accuracy of its projections; if local efforts to resolve the problem were ineffective or nonexistent, then HUD could impose stricter public benefit standards upon the grantee. HUD does not intend that problems by one state recipient should be cause for sanctions against an entire state's program.

HUD does not consider it useful to attempt to define what actions are ''reasonably within the grantee's control'', as every situation would involve a judgement call as to what could or should be done. The concept of deferring entirely to a state's judgement about what actions could or should be taken (against a state grant recipient) is impractical, given HUD's statutory mandate to determine grantees' compliance.

The paragraphs on documentation have been revised to respond to all the above comments, and to provide greater clarity of meaning. In addition, § 570.482(f)(6) of the final State regulations clarifies HUD's expectations upon states concerning local governments' performance.

Amendments to Projects After Determinations

Four commenters (three local governments and one national association) commented on the paragraphs concerning amendments to projects after a funding decision has been reached.

Issue. Three commenters questioned as imprecise HUD's use of the term ''material change'' in referring to situations in which a grantee should reevaluate a project (after committing funding to it) because of changes in the project. One commenter felt the proposed wording implied that reanalysis would be required for any change, which would in their opinion be overkill. Another commenter suggested use of the term ''substantial change'', which is used in the existing Entitlement regulations to describe situations in which the Final Statement must be amended.

Response. It is not the Department's intent that any change in a project should necessitate its complete reevaluation. Minor changes, such as the shifting of small dollar amounts among budget categories, or a one-month extension to the construction period, probably would not affect the underlying assumptions upon which a grantee decided to assist the project. However, if the project changes to the extent that the revised project would be very different in its scope, public benefit, total cost or CDBG cost (compared to the project as initially approved by the grantee), the Department believes that the project should be reexamined under the public benefit and underwriting guidelines. A grantee should confirm whether it still wishes to participate in the project, whether the costs and benefits of the project are still reasonable, and whether the amount of public benefit is still reasonable given the amount of assistance being provided.

In the final regulations, these paragraphs have been rewritten to state that a project should be reevaluated if the project changes to the extent that ''a significant amendment to the contract (with the business) is appropriate.'' The use of the term ''substantial'' was avoided, as some might attempt to apply the same concept of ''substantial'' as used concerning Final Statement amendments—a borrowing of concepts which the Department feels is not appropriate or relevant. The Department has chosen not to define what constitutes a ''significant amendment'', nor to define the types of changes which

would call for reevaluation. Grantees are strongly encouraged, in developing their guidelines, to define what they will consider to be ''significant changes'', and to identify how they will reevaluate projects.

Issue. One commenter objected to the example provided at the end of the paragraph concerning a situation in which total project costs change. In this example, the Department suggested that if total project costs decreased, it would be appropriate to reduce the amount of CDBG assistance to the project. The commenter felt that this implies that any reduction in total project cost should automatically result in a comparable reduction in the amount of CDBG assistance, which may not be practical. The commenter recommended eliminating the example.

Response. The Department concurs with the basic point that it may not always be appropriate to reduce the amount of CDBG assistance in such cases. The example has been retained in the final rule, but has been modified to state that ''it may be appropriate'' to reduce the amount of CDBG assistance. The final regulation also notes that when a project is amended to receive additional CDBG assistance, the project as amended must still comply with the public benefit standards.

Modification to the Definition of Subrecipient Related to Microenterprise Assistance Activities

Issue. As noted earlier under the CBDO discussion regarding § 570.204 of the Entitlement regulations (Section 105(a)(15) of the Act), five commenters addressed the proposed revision to the definition of the term ''subrecipient'' at § 570.500(c) to expand that provision to include for-profit entities that are now specifically authorized by statute to carry out microenterprise assistance activities under the new eligibility provision implemented in this final rule by a new § 570.201(o) in the Entitlement regulations [Section 105(a)(23) of the Act]. Most of the commenters recommended that HUD not consider any entities carrying out activities under the new microenterprise category as ''subrecipients'' but rather as ''end beneficiaries.'' These commenters also requested a similar change in classification for entities receiving CDBG assistance under § 570.204 of the Entitlement regulations [Section 105(a)(15) of the Act]. Other commenters asked only for a clarification of the proposed revision to § 570.500(c). (1 local government agency, 1 development organization, and 3 HUD Field staff persons)

Response. The new Section 105(a)(23) of the Act authorizes ''the provision of assistance to public and private organizations, agencies, and other entities (including nonprofit and for-profit entities) to enable such entities to facilitate economic development'' by providing various forms of assistance to owners of microenterprises and persons developing microenterprises. The Department interprets this provision to mean that any such entities beyond the grantee itself are to serve as intermediaries in the grant assistance chain rather than being considered beneficiaries in and of themselves. Thus, the Department considers such organizations to be subrecipients under the CDBG program. The existing definition of the term ''subrecipient'' at § 570.500(c) of the CDBG Entitlement regulations is being revised in this final rule only to include a specific reference to the for-profit entities now authorized to carry out microenterprise assistance activities. (Nonprofit entities carrying out such activities are already covered by the existing definition of a ''subrecipient.'') The language in the proposed change to § 570.500(c) has been revised, however, to clarify the Department's intent.

Other Issues Regarding Income Documentation

Issue. One commenter recommended that HUD take this opportunity to clarify what is meant by a ''verifiable certification'' as the term is used in § 570.506(b). The commenter asks whether this term implies that a sample of the certifications should be verified. (1 private citizen)

Response. HUD does not believe that this issue need be further specified in the text of the regulation itself. However, as guidance for grantees, it should be noted that, over time, HUD does expect that some sample of such certifications would be verified by the grantee or subrecipient, as applicable. This verification is important to maintaining program accountability and integrity.

Issue. One commenter raised concerns about the burden of keeping family size and income data for job creation or retention activities. As another option, the commenter recommended that HUD only look at the wages of the individual employee and compare that figure against the income limits for one-person households. (1 development organization)

Response. HUD cannot accept this recommendation. First, the proposal is not consistent with the general statutory definition of a low- and moderate-income person as being a member of a low- and moderate-income family. Secondly, the proposal's use of the wages of a created job as the basis for determining a person's income status runs counter to CDBG program requirements. To be counted toward compliance with low- and moderate-income national objective compliance, a person need only be low- and moderate-income at the time the CDBG assistance is provided, i.e., for a created job, at the time he or she is hired. The CDBG program does not and should not impose any requirement that the person would have to stay low- and moderate-income based on the wages of the created job. Finally, it should be noted that presumptions added by the 1992 Act for determining whether a person is considered low- and moderate-income for job creation or retention activities, as implemented in this final rule, should significantly reduce the burden described by the commenter.

Issue. One commenter stated that, in regard to the State CDBG program, it is good that HUD is consulting and negotiating with States on record keeping issue, but the commenter complained that the number of States being consulted was too small. The commenter argued that HUD should negotiate record keeping requirements with each and every State because since they represent such broad and varied regions. (1 state agency)

Response. It is not logistically possible for HUD to negotiate with each and every State before issuing record keeping regulations for the State CDBG program. HUD is still negotiating with a sample of States and is hoping to devise certain minimum record keeping standards for States that will be accepted on a consensus basis.

Other Issues Not Specifically Addressed in the Proposed Rule

A number of comments were received on issues not specifically addressed in the proposed regulations, but which were seen (by commenters) as having significant bearing on the use of CDBG funds for economic development activity.

Issue. Two commenters (both local governments) requested that the Department address the issue of using CDBG funds for economic development activities on military bases which are being closed.

Response. The Department does not see the reuse or redevelopment of closed military bases as an activity per se, but rather a goal which CDBG funds can be used to address. The Department believes the current regulations concerning eligibility and national objectives, along with these revised

regulations, give communities considerable flexibility to carry out a broad range of economic development activities, including those on former military bases.

Issue. Six commenters (3 national associations, 2 states and one local government) identified other Federal requirements as major inhibitors to the use of CDBG for economic development (particularly for microenterprise assistance), and asked the Department to examine ways to streamline these other requirements. Specifically identified were environmental review procedures, program income requirements, and the Davis-Bacon Wage Rate Act.

Response. HUD acknowledges that these areas are the source of frequent complaints. However, as some commenters noted, the underlying bases for many of the regulatory requirements in these areas are statutory, and thus lie beyond HUD's span of control. HUD is willing to explore ways in which regulations governing these other federal requirements might be made more amenable to the use of CDBG funds for economic development.

In particular, the Department realizes that CDBG regulations governing the use of CDBG program income must be revised to include 1992 changes to the Act. Issues concerning program income will be dealt with more comprehensively in separate future rule-making. In the meantime, and in response to these comments, the Department has identified three incremental changes which can be made regarding program income, and has included them in this final rule.

1. The 1992 State CDBG program regulations included a provision excluding from the definition of program income an amount of up to $10,000 per year per state grant recipient. This provision was consistent with 1992 amendments to the Act, which permitted the Secretary to exclude from program requirements amounts of program income that are determined to be so small that compliance with requirements would place an unreasonable administrative burden on units of local government. During the past two years, a number of states have commented to HUD that many of their grant recipients regularly receive over $10,000 per year in program income; thus, at its present level, this exclusion provision is of little or no benefit to state grant recipients. Since state grant award amounts are typically smaller than the average yearly entitlement grant amount, state grant recipients typically receive less program per year than entitlement grantees. The problem noted by states is likely to be equally or more problematic for entitlement grantees.

The Department has determined that $25,000 is a more appropriate level at which to set the yearly exclusion amount. These final regulations also extend the exclusion provision to the Entitlement program for the first time. In a separate rulemaking, the Department is also adding the exclusion provision to the HUD-Administered Small Cities program regulations.

2. The existing definition of program income includes revenue generated by activities carried out with the proceeds from loans guaranteed under Section 108. Such revenue is now treated as program income even if the guaranteed loan is repaid with non-CDBG funds. Such revenue is treated as program income notwithstanding that it is required to be pledged to the repayment of the Section 108 loan. The final rule excludes from the definition of program income certain amounts generated by activities financed by Section 108 loans, to the extent that non-CDBG funds are used to repay the loan. Activities which can qualify for this exclusion are those meeting the criteria at § 570.209(b)(2)(v) or § 570.482(f)(3)(v) (the ''important national interest'' activities), and those carried out in conjunction with an Economic Development Initiative grant in an area determined by the Department to meet the eligibility requirements for Urban Empowerment Zone designation.

Any revenue generated by activities financed with Section 108 loan guarantees which is not defined as program income would be miscellaneous revenue. In addition, any amounts in debt service accounts that were funded with non-CDBG funds (e.g. Section 108 funds and monies provided by the assisted business) that remain after full and final repayment of the guaranteed loan would also be considered miscellaneous revenue.

3. As discussed earlier under the heading of Community-Based Development Organizations, the Department has substantially revised the requirements governing activities funded under § 105(a)(15) of the Act (and § 570.204 of the Entitlement regulations). As a result of those changes, the department has determined that amounts generated by such activities can also be excluded from the requirements governing the use of program income.

Because § 105(a)(15) of the Act differentiates between the types of eligible entities in entitlement jurisdictions and nonentitled areas, this change has been effected by different means for the Entitlement and State CDBG programs. Section 570.500(c) of the Entitlement regulations, which defines the term ''subrecipient'', has been revised; entities described in § 570.204(c) [which implements § 105(a)(15) of the Act], are no longer defined as subrecipients. As noted previously, the term ''subrecipient'' is not defined in the State CDBG program. Section 570.489(e) of the State rule (which comprises program income requirements) has been revised to exclude from the definition of program income amounts generated by § 105(a)(15) activities. States are expected to ensure that any such activities are indeed carried out by an entity pursuant to § 105(a)(15).

It should be noted that this exclusion does not cover situations in which a grantee provides CDBG assistance to one of these entities in the form of a loan. Any repayments of principal or interest from the entity to the grantee for such a loan would be considered to be CDBG program income, regardless of the source of the funds used for repayment.

Issue. Numerous commenters noted that HUD needs to provide additional training for grantees and HUD Field Office staff to ensure uniform understanding, interpretation and implementation of the revised regulations. HUD should also go beyond formal training to provide other mechanisms (such as national conferences, development of model programs, resource guidebooks and computer bulletin boards) for sharing information on economic development activities. Areas in which certain commenters were particularly interested in seeing greater information-sharing included: related federal initiatives such as welfare reform and Empowerment Zones/Enterprise Communities; sharing of model programs; microenterprise assistance programs; use of ''first source'' agreements for job creation activities; and combining CDBG with other federal economic development resources.

Response. The Department acknowledges the importance of training on new regulations, and is planning to provide training to both grantees and HUD Field Office staff once these regulations are effective. HUD is also developing a CDBG economic development reference manual which will include model programs. The Department's Consolidated Technical Assistance initiative, which is already being implemented, should also result in additional training opportunities on economic development issues.

The Department plans to develop guidelines by which those communities

demonstrating the best performance in the area of economic development may be identified. These guidelines will be distributed to both grantees and HUD Field Office staff. The Department will also identify administrative mechanisms through which additional relief may be provided to communities with the best economic development performance records.

Relationship to Section 3 Economic Opportunity Requirements

Recipients of CDBG funds must also comply with the requirements of Section 3 of the Housing and Urban Development Act of 1968 (Section 3), as amended by Section 915 of the 1992 Act. Section 3 requires that, to the greatest extent feasible, and consistent with existing Federal, State and local laws and regulations, employment and other economic opportunities arising in connection with CDBG assistance to any Section 3 covered project are given to low- and very low-income persons residing within the metropolitan area (or nonmetropolitan county) in which the project is located. For the CDBG program, Section 3 covered projects include housing rehabilitation, housing construction, and other public construction. The Section 3 requirements apply to training, employment and contracting opportunities arising in connection with a covered project, as well as job (or other opportunities) which may be retained or created as a result of the project. An interim rule implementing the 1992 amendments to Section 3 was published by the Department in the **Federal Register** on June 30, 1994, and it became effective August 1, 1994.

Other Matters

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that the policies in this rule do not have Federalism implications when implemented and, thus, are not subject to review under the Order. Nothing in the rule implies any preemption of State or local law, nor does any provision of the rule disturb the existing relationship between the Federal Government and State and local governments.

Executive Order 12606, the Family

The General Counsel, as the designated Official under Executive Order 12606, has determined that this rule does not have potential significant impact on family formation, maintenance, and general well-being, and, thus, is not subject to review under the Order.

Environmental Finding

A Finding of No Significant Impact with regard to the environment has been made in accordance with HUD regulations in 24 CFR part 50, which implement section 102(2)(C) of the National Environmental Policy Act of 1969, 42 U.S.C. 4321. The Finding of No Significant Impact is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Room 10276, 451 Seventh Street, SW., Washington, DC 20410.

Regulatory Flexibility

Under the Regulatory Flexibility Act (5 U.S.C. 605(b)), the Secretary by his approval of publication of this rule hereby certifies that this rule does not have a significant economic impact on a substantial number of small entities. The rule does not affect the amount of funds provided in the CDBG program, but rather modifies and updates program administration and procedural requirements to comport with recently enacted legislation.

Semiannual Agenda

This rule was listed as item 1848 in the Department's Semiannual Agenda of Regulations published on November 14, 1994 (59 FR 57632, 57664) under Executive Order 12866 and the Regulatory Flexibility Act.

Catalog of Federal Domestic Assistance

The Community Development Block Grant Program is listed in the Catalog of Federal Domestic Assistance under the following numbers: Entitlements—14.218, HUD-administered Small Cities—14.219, Indian—14.223, Insular Areas—14.225, State's Program—14.228.

List of Subjects in 24 CFR Part 570

Administrative practice and procedure, American Samoa, Community development block grants, Grant programs—education, Grant programs—housing and community development, Guam, Indians, Lead poisoning, Loan programs—housing and community development, Low and moderate income housing, New communities, Northern Mariana Islands, Pacific Islands Trust Territory, Pockets of poverty, Puerto Rico, Reporting and recordkeeping requirements, Small cities, Student aid, Virgin Islands.

Accordingly, 24 CFR part 570, subparts A, C, I, and J, are amended as follows:

PART 570—COMMUNITY DEVELOPMENT BLOCK GRANTS

1. The authority citation for 24 CFR part 570 continues to read as follows:

Authority: 42 U.S.C. 3535(d) and 5300–5320.

Subpart A—General Provisions

2. In § 570.3, definitions for ''Community Development Financial Institution'', ''Microenterprise'', and ''Small business'', are added in alphabetical order to read as follows:

§ 570.3 Definitions.

* * * * *

Community Development Financial Institution has the same meaning as used in the Community Development Banking and Financial Institutions Act of 1994 (12 U.S.C. 4701 note).

* * * * *

Microenterprise means a business that has five or fewer employees, one or more of whom owns the enterprise.

* * * * *

Small business means a business that meets the criteria set forth in section 3(a) of the Small Business Act (15 U.S.C. 631, 636, 637).

* * * * *

Subpart C—Eligible Activities

3. In § 570.200, paragraph (e) is revised to read as follows:

§ 570.200 General policies.

* * * * *

(e) *Recipient determinations required as a condition of eligibility.* In several instances under this subpart, the eligibility of an activity depends on a special local determination. Recipients shall maintain documentation of all such determinations. A written determination is required for any activity carried out under the authority of §§ 570.201(f), 570.202(b)(3), 570.204, 570.206(f), and 570.209.

* * * * *

4. In § 570.201, paragraph (o) is added to read as follows:

§ 570.201 Basic eligible activities.

* * * * *

(o)(1) The provision of assistance either through the recipient directly or through public and private organizations, agencies, and other subrecipients (including nonprofit and for-profit subrecipients) to facilitate economic development by:

(i) Providing credit, including, but not limited to, grants, loans, loan guarantees, and other forms of financial support, for the establishment,

stabilization, and expansion of microenterprises;

(ii) Providing technical assistance, advice, and business support services to owners of microenterprises and persons developing microenterprises; and

(iii) Providing general support, including, but not limited to, peer support programs, counseling, child care, transportation, and other similar services, to owners of microenterprises and persons developing microenterprises.

(2) Services provided this paragraph (o) shall not be subject to the restrictions on public services contained in paragraph (e) of this section.

(3) For purposes of this paragraph (o), ''persons developing microenterprises'' means such persons who have expressed interest and who are, or after an initial screening process are expected to be, actively working toward developing businesses, each of which is expected to be a microenterprise at the time it is formed.

5. In § 570.202, paragraph (a)(1) is revised to read as follows:

§ 570.202 Eligible rehabilitation and preservation activities.

(a) * * *

(1) Privately owned buildings and improvements for residential purposes; improvements to a single-family residential property which is also used as a place of business, which are required in order to operate the business, need not be considered to be rehabilitation of a commercial or industrial building, if the improvements also provide general benefit to the residential occupants of the building;

* * * * *

6. Section 570.203 is amended by revising the introductory text and paragraph (b), and by adding a new paragraph (c), to read as follows:

§ 570.203 Special economic development activities.

A recipient may use CDBG funds for special economic development activities in addition to other activities authorized in this subpart which may be carried out as part of an economic development project. Guidelines for selecting activities to assist under this paragraph are provided at § 570.209. The recipient must ensure that the appropriate level of public benefit will be derived pursuant to those guidelines before obligating funds under this authority. Special activities authorized under this section do not include assistance for the construction of new housing. Special economic development activities include:

* * * * *

(b) The provision of assistance to a private for-profit business, including, but not limited to, grants, loans, loan guarantees, interest supplements, technical assistance, and other forms of support, for any activity where the assistance is appropriate to carry out an economic development project, excluding those described as ineligible in § 570.207(a). In selecting businesses to assist under this authority, the recipient shall minimize, to the extent practicable, displacement of existing businesses and jobs in neighborhoods.

(c) Economic development services in connection with activities eligible under this section, including, but not limited to, outreach efforts to market available forms of assistance; screening of applicants; reviewing and underwriting applications for assistance; preparation of all necessary agreements; management of assisted activities; and the screening, referral, and placement of applicants for employment opportunities generated by CDBG-eligible economic development activities, including the costs of providing necessary training for persons filling those positions.

7. Section 570.204 is revised to read as follows:

§ 570.204 Special activities by Community-Based Development Organizations (CBDOs).

(a) *Eligible activities.* The recipient may provide CDBG funds as grants or loans to any CBDO qualified under this section to carry out a neighborhood revitalization, community economic development, or energy conservation project. The funded project activities may include those listed as eligible under this subpart, and, except as described in paragraph (b) of this section, activities not otherwise listed as eligible under this subpart. For purposes of qualifying as a project under paragraphs (a)(1), (a)(2), and (a)(3) of this section, the funded activity or activities may be considered either alone or in concert with other project activities either being carried out or for which funding has been committed. For purposes of this section:

(1) Neighborhood revitalization project includes activities of sufficient size and scope to have an impact on the decline of a geographic location within the jurisdiction of a unit of general local government (but not the entire jurisdiction) designated in comprehensive plans, ordinances, or other local documents as a neighborhood, village, or similar geographical designation; or the entire jurisdiction of a unit of general local government which is under 25,000 population;

(2) Community economic development project includes activities that increase economic opportunity, principally for persons of low- and moderate-income, or that stimulate or retain businesses or permanent jobs, including projects that include one or more such activities that are clearly needed to address a lack of affordable housing accessible to existing or planned jobs and those activities specified at 24 CFR 91.1(a)(1)(iii);

(3) Energy conservation project includes activities that address energy conservation, principally for the benefit of the residents of the recipient's jurisdiction; and

(4) To carry out a project means that the CBDO undertakes the funded activities directly or through contract with an entity other than the grantee, or through the provision of financial assistance for activities in which it retains a direct and controlling involvement and responsibilities.

(b) *Ineligible activities.* Notwithstanding that CBDOs may carry out activities that are not otherwise eligible under this subpart, this section does not authorize:

(1) Carrying out an activity described as ineligible in § 570.207(a);

(2) Carrying out public services that do not meet the requirements of § 570.201(e), except that:

(i) Services carried out under this section that are specifically designed to increase economic opportunities through job training and placement and other employment support services, including, but not limited to, peer support programs, counseling, child care, transportation, and other similar services; and

(ii) Services of any type carried out under this section pursuant to a strategy approved by HUD under the provisions of 24 CFR 91.215(e) shall not be subject to the limitations in § 570.201(e)(1) or (2), as applicable;

(3) Providing assistance to activities that would otherwise be eligible under § 570.203 that do not meet the requirements of § 570.209; or

(4) Carrying out an activity that would otherwise be eligible under § 570.205 or § 570.206, but that would result in the recipient's exceeding the spending limitation in § 570.200(g).

(c) *Eligible CBDOs.* (1) A CBDO qualifying under this section is an organization which has the following characteristics:

(i) Is an association or corporation organized under State or local law to engage in community development activities (which may include housing

and economic development activities) primarily within an identified geographic area of operation within the jurisdiction of the recipient, or in the case of an urban county, the jurisdiction of the county; and

(ii) Has as its primary purpose the improvement of the physical, economic or social environment of its geographic area of operation by addressing one or more critical problems of the area, with particular attention to the needs of persons of low and moderate income; and

(iii) May be either non-profit or for-profit, provided any monetary profits to its shareholders or members must be only incidental to its operations; and

(iv) Maintains at least 51 percent of its governing body's membership for low- and moderate-income residents of its geographic area of operation, owners or senior officers of private establishments and other institutions located in and serving its geographic area of operation, or representatives of low- and moderate-income neighborhood organizations located in its geographic area of operation; and

(v) Is not an agency or instrumentality of the recipient and does not permit more than one-third of the membership of its governing body to be appointed by, or to consist of, elected or other public officials or employees or officials of an ineligible entity (even though such persons may be otherwise qualified under paragraph (c)(1)(iv) of this section); and

(vi) Except as otherwise authorized in paragraph (c)(1)(v) of this section, requires the members of its governing body to be nominated and approved by the general membership of the organization, or by its permanent governing body; and

(vii) Is not subject to requirements under which its assets revert to the recipient upon dissolution; and

(viii) Is free to contract for goods and services from vendors of its own choosing.

(2) A CBDO that does not meet the criteria in paragraph (c)(1) of this section may also qualify as an eligible entity under this section if it meets one of the following requirements:

(i) Is an entity organized pursuant to section 301(d) of the Small Business Investment Act of 1958 (15 U.S.C. 681(d)), including those which are profit making; or

(ii) Is an SBA approved Section 501 State Development Company or Section 502 Local Development Company, or an SBA Certified Section 503 Company under the Small Business Investment Act of 1958, as amended; or

(iii) Is a Community Housing Development Organization (CHDO) under 24 CFR 92.2, designated as a CHDO by the HOME Investment Partnerships program participating jurisdiction, with a geographic area of operation of no more than one neighborhood, and has received HOME funds under 24 CFR 92.300 or is expected to receive HOME funds as described in and documented in accordance with 24 CFR 92.300(e).

(3) A CBDO that does not qualify under paragraphs (c) (1) or (2) of this section may also be determined to qualify as an eligible entity under this section if the recipient demonstrates to the satisfaction of HUD, through the provision of information regarding the organization's charter and by-laws, that the organization is sufficiently similar in purpose, function, and scope to those entities qualifying under paragraphs (c) (1) or (2) of this section.

8. Section 570.207 is amended by revising paragraphs (b) introductory text and (b)(3)(iii) to read as follows:

§ 570.207 Ineligible activities.

* * * * *

(b) The following activites may not be assisted with CDBG funds unless authorized under provisions of § 570.203 or as otherwise specifically noted herein or when carried out by a entity under the provisions of § 570.204.

* * * * *

(3) * * *

(iii) When carried out by an entity pursuant to § 570.204(a);

* * * * *

9. Section 570.208 is amended by:

a. Revising the paragraph heading of paragraph (a), revising paragraph (a)(1)(i), the first sentence in paragraph (a)(1)(iv), and adding a new paragraph (a)(1)(v);

b. Revising paragraph (a)(2)(i) introductory text and by adding new paragraphs (a)(2)(iii) and (a)(2)(iv);

c. Revising the introductory text of paragraph (a)(3);

d. Revising paragraph (a)(4); and

e. Adding new paragraphs (d)(5), (d)(6), and (d)(7), to read as follows:

§ 570.208 Criteria for national objectives.

* * * * *

(a) *Activities benefiting low- and moderate-income persons.*

* * * * *

(1) *Area benefit activities.* (i) An activity, the benefits of which are available to all the residents in a particular area, where at least 51 percent of the residents are low and moderate income persons. Such an area need not be coterminous with census tracts or other officially recognized boundaries but must be the entire area served by the activity. An activity that serves an area that is not primarily residential in character shall not qualify under this criterion.

* * * * *

(iv) In determining whether there is a sufficiently large percentage of low and moderate income persons residing in the area served by an activity to qualify under paragraphs (a)(1)(i), (ii), or (v) of this section, the most recently available decennial census information shall be used to the fullest extent feasible, together with the Section 8 income limits that would have applied at the time the income information was collected by the Census Bureau. * * *

(v) Activities meeting the requirements of paragraph (d)(5)(i) of this section may be considered to qualify under this paragraph, provided that the area covered by the strategy is primarily residential and contains a percentage of low- and moderate-income residents that is no less than the percentage computed by HUD pursuant to paragraph (a)(1)(ii) of this section but in no event less than 51 percent. Activities meeting the requirements of paragraph (d)(6)(i) of this section may also be considered to qualify under paragraph (a)(1) of this section.

(2) *Limited clientele activities.* (i) An activity which benefits a limited clientele, at least 51 percent of whom are low- or moderate-income persons. (The following kinds of activities may not qualify under paragraph (a)(2) of this section: activities, the benefits of which are available to all the residents of an area; activities involving the acquisition, construction or rehabilitation of property for housing; or activities where the benefit to low- and moderate-income persons to be considered is the creation or retention of jobs, except as provided in paragraph (a)(2)(iv) of this section.) To qualify under paragraph (a)(2) of this section, the activity must meet one of the following tests:

* * * * *

(iii) A microenterprise assistance activity carried out in accordance with the provisions of § 570.201(o) with respect to those owners of microenterprises and persons developing microenterprises assisted under the activity during each program year who are low- and moderate-income persons. For purposes of this paragraph, persons determined to be low and moderate income may be presumed to continue to qualify as such for up to a three-year period.

(iv) An activity designed to provide job training and placement and/or other employment support services, including, but not limited to, peer support programs, counseling, child care, transportation, and other similar services, in which the percentage of low- and moderate-income persons assisted is less than 51 percent may qualify under this paragraph in the following limited circumstance:

(A) In such cases where such training or provision of supportive services assists business(es), the only use of CDBG assistance for the project is to provide the job training and/or supportive services; and

(B) The proportion of the total cost of the project borne by CDBG funds is no greater than the proportion of the total number of persons assisted who are low or moderate income.

(3) *Housing activities.* An eligible activity carried out for the purpose of providing or improving permanent residential structures which, upon completion, will be occupied by low- and moderate-income households. This would include, but not necessarily be limited to, the acquisition or rehabilitation of property, conversion of non-residential structures, and new housing construction. If the structure contains two dwelling units, at least one must be so occupied, and if the structure contains more than two dwelling units, at least 51 percent of the units must be so occupied. Where two or more rental buildings being assisted are or will be located on the same or contiguous properties, and the buildings will be under common ownership and management, the grouped buildings may be considered for this purpose as a single structure. Where housing activities being assisted meet the requirements of paragraph § 570.208 (d)(5)(ii) or (d)(6)(ii) of this section, all such housing may also be considered for this purpose as a single structure. For rental housing, occupancy by low and moderate income households must be at affordable rents to qualify under this criterion. The recipient shall adopt and make public its standards for determining ''affordable rents'' for this purpose. The following shall also qualify under this criterion:

* * * * *

(4) *Job creation or retention activities.* An activity designed to create or retain permanent jobs where at least 51 percent of the jobs, computed on a full time equivalent basis, involve the employment of low- and moderate-income persons. To qualify under this paragraph, the activity must meet the following criteria:

(i) For an activity that creates jobs, the recipient must document that at least 51 percent of the jobs will be held by, or will be available to, low- and moderate-income persons.

(ii) For an activity that retains jobs, the recipient must document that the jobs would actually be lost without the CDBG assistance and that either or both of the following conditions apply with respect to at least 51 percent of the jobs at the time the CDBG assistance is provided:

(A) The job is known to be held by a low- or moderate-income person; or

(B) The job can reasonably be expected to turn over within the following two years and that steps will be taken to ensure that it will be filled by, or made available to, a low- or moderate-income person upon turnover.

(iii) Jobs that are not held or filled by a low- or moderate-income person may be considered to be available to low- and moderate-income persons for these purposes only if:

(A) Special skills that can only be acquired with substantial training or work experience or education beyond high school are not a prerequisite to fill such jobs, or the business agrees to hire unqualified persons and provide training; and

(B) The recipient and the assisted business take actions to ensure that low- and moderate-income persons receive first consideration for filling such jobs.

(iv) For purposes of determining whether a job is held by or made available to a low- or moderate-income person, the person may be presumed to be a low- or moderate-income person if:

(A) He/she resides within a census tract (or block numbering area) that either:

(*1*) Meets the requirements of paragraph (a)(4)(v) of this section; or

(*2*) Has at least 70 percent of its residents who are low- and moderate-income persons; or

(B) The assisted business is located within a census tract (or block numbering area) that meets the requirements of paragraph (a)(4)(v) of this section and the job under consideration is to be located within that census tract.

(v) A census tract (or block numbering area) qualifies for the presumptions permitted under paragraphs (a)(4)(iv)(A)(*1*) and (B) of this section if it is either part of a Federally-designated Empowerment Zone or Enterprise Community or meets the following criteria:

(A) It has a poverty rate of at least 20 percent as determined by the most recently available decennial census information;

(B) It does not include any portion of a central business district, as this term is used in the most recent Census of Retail Trade, unless the tract has a poverty rate of at least 30 percent as determined by the most recently available decennial census information; and

(C) It evidences pervasive poverty and general distress by meeting at least one of the following standards:

(*1*) All block groups in the census tract have poverty rates of at least 20 percent;

(*2*) The specific activity being undertaken is located in a block group that has a poverty rate of at least 20 percent; or

(*3*) Upon the written request of the recipient, HUD determines that the census tract exhibits other objectively determinable signs of general distress such as high incidence of crime, narcotics use, homelessness, abandoned housing, and deteriorated infrastructure or substantial population decline.

(vi) As a general rule, each assisted business shall be considered to be a separate activity for purposes of determining whether the activity qualifies under this paragraph, except:

(A) In certain cases such as where CDBG funds are used to acquire, develop or improve a real property (e.g., a business incubator or an industrial park) the requirement may be met by measuring jobs in the aggregate for all the businesses which locate on the property, provided such businesses are not otherwise assisted by CDBG funds.

(B) Where CDBG funds are used to pay for the staff and overhead costs of a subrecipient making loans to businesses exclusively from non-CDBG funds, this requirement may be met by aggregating the jobs created by all of the businesses receiving loans during each program year.

(C) Where CDBG funds are used by a recipient or subrecipient to provide technical assistance to businesses, this requirement may be met by aggregating the jobs created or retained by all of the businesses receiving technical assistance during each program year.

(D) Where CDBG funds are used for activities meeting the criteria listed at § 570.209(b)(2)(v), this requirement may be met by aggregating the jobs created or retained by all businesses for which CDBG assistance is obligated for such activities during the program year, except as provided at paragraph (d)(7) of this section.

(E) Where CDBG funds are used by a Community Development Financial Institution to carry out activities for the purpose of creating or retaining jobs, this requirement may be met by

aggregating the jobs created or retained by all businesses for which CDBG assistance is obligated for such activities during the program year, except as provided at paragraph (d)(7) of this section.

(F) Where CDBG funds are used for public facilities or improvements which will result in the creation or retention of jobs by more than one business, this requirement may be met by aggregating the jobs created or retained by all such businesses as a result of the public facility or improvement.

(1) Where the public facility or improvement is undertaken principally for the benefit of one or more particular businesses, but where other businesses might also benefit from the assisted activity, the requirement may be met by aggregating only the jobs created or retained by those businesses for which the facility/improvement is principally undertaken, provided that the cost (in CDBG funds) for the facility/improvement is less than $10,000 per permanent full-time equivalent job to be created or retained by those businesses.

(2) In any case where the cost per job to be created or retained (as determined under paragraph (a)(4)(v)(C)*(1)* of this section) is $10,000 or more, the requirement must be met by aggregating the jobs created or retained as a result of the public facility or improvement by all businesses in the service area of the facility/improvement. This aggregation must include businesses which, as a result of the public facility/improvement, locate or expand in the service area of the facility/improvement between the date the recipient identifies the activity in its final statement and the date one year after the physical completion of the facility/improvement. In addition, the assisted activity must comply with the public benefit standards at § 570.209(b).

* * * * *

(d) * * *

(5) Where the grantee has elected to prepare an area revitalization strategy pursuant to the authority of § 91.215(e) of this title and HUD has approved the strategy, the grantee may also elect the following options:

(i) Activities undertaken pursuant to the strategy for the purpose of creating or retaining jobs may, at the option of the grantee, be considered to meet the requirements of this paragraph under the criteria at paragraph (a)(1)(v) of this section in lieu of the criteria at paragraph (a)(4) of this section; and

(ii) All housing activities in the area for which, pursuant to the strategy, CDBG assistance is obligated during the program year may be considered to be a single structure for purposes of applying the criteria at paragraph (a)(3) of this section.

(6) Where CDBG-assisted activities are carried out by a Community Development Financial Institution whose charter limits its investment area to a primarily residential area consisting of at least 51 percent low- and moderate-income persons, the grantee may also elect the following options:

(i) Activities carried out by the Community Development Financial Institution for the purpose of creating or retaining jobs may, at the option of the grantee, be considered to meet the requirements of this paragraph under the criteria at paragraph (a)(1)(v) of this section in lieu of the criteria at paragraph (a)(4) of this section; and

(ii) All housing activities for which the Community Development Financial Institution obligates CDBG assistance during the program year may be considered to be a single structure for purposes of applying the criteria at paragraph (a)(3) of this section.

(7) Where an activity meeting the criteria at § 570.209(b)(2)(v) may also meet the requirements of either paragraph (d)(5)(i) or (d)(6)(i) of this section, the grantee may elect to qualify the activity under either the area benefit criteria at paragraph (a)(1)(v) of this section or the job aggregation criteria at paragraph (a)(4)(vi)(D) of this section, but not both. Where an activity may meet the job aggregation criteria at both paragraphs (a)(4)(vi) (D) and (E) of this section, the grantee may elect to qualify the activity under either criterion, but not both.

10. A new § 570.209 is added to subpart C to read as follows:

§ 570.209 Guidelines for evaluating and selecting economic development projects.

The following guidelines are provided to assist the recipient to evaluate and select activities to be carried out for economic development purposes. Specifically, these guidelines are applicable to activities that are eligible for CDBG assistance under § 570.203. These guidelines also apply to activities carried out under the authority of § 570.204 that would otherwise be eligible under § 570.203, were it not for the involvement of a Community-Based Development Organization (CBDO). (This would include activities where a CBDO makes loans to for-profit businesses.) These guidelines are composed of two components: guidelines for evaluating project costs and financial requirements; and standards for evaluating public benefit. The standards for evaluating public benefit are *mandatory,* but the guidelines for evaluating projects costs and financial requirements are not.

(a) *Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.* HUD has developed guidelines that are designed to provide the recipient with a framework for financially underwriting and selecting CDBG-assisted economic development projects which are financially viable and will make the most effective use of the CDBG funds. These guidelines, also referred to as the underwriting guidelines, are published as appendix A to this part. The use of the underwriting guidelines published by HUD is not mandatory. However, grantees electing not to use these guidelines would be expected to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business. Where appropriate, HUD's underwriting guidelines recognize that different levels of review are appropriate to take into account differences in the size and scope of a proposed project, and in the case of a microenterprise or other small business to take into account the differences in the capacity and level of sophistication among businesses of differing sizes. Recipients are encouraged, when they develop their own programs and underwriting criteria, to also take these factors into account. The objectives of the underwriting guidelines are to ensure:

(1) That project costs are reasonable;

(2) That all sources of project financing are committed;

(3) That to the extent practicable, CDBG funds are not substituted for non-Federal financial support;

(4) That the project is financially feasible;

(5) That to the extent practicable, the return on the owner's equity investment will not be unreasonably high; and

(6) That to the extent practicable, CDBG funds are disbursed on a pro rata basis with other finances provided to the project.

(b) *Standards for Evaluating Public Benefit.* The grantee is responsible for making sure that at least a minimum level of public benefit is obtained from the expenditure of CDBG funds under the categories of eligibility governed by these guidelines. The standards set forth below identify the types of public benefit that will be recognized for this purpose and the minimum level of each that must be obtained for the amount of CDBG funds used. Unlike the guidelines for project costs and financial requirements covered under paragraph (a) of this section, the use of the standards for public benefit is mandatory. Certain public facilities and

improvements eligible under § 570.201(c) of the regulations, which are undertaken for economic development purposes, are also subject to these standards, as specified in § 570.208(a)(4)(vi)(D)*(2)*.

(1) *Standards for activities in the aggregate.* Activities covered by these guidelines must, in the aggregate, either:

(i) Create or retain at least one full-time equivalent, permanent job per $35,000 of CDBG funds used; or

(ii) Provide goods or services to residents of an area, such that the number of low- and moderate-income persons residing in the areas served by the assisted businesses amounts to at least one low- and moderate-income person per $350 of CDBG funds used.

(2) *Applying the aggregate standards.* (i) A metropolitan city or an urban county shall apply the aggregate standards under paragraph (b)(1) of this section to all applicable activities for which CDBG funds are first obligated within each single CDBG program year, without regard to the source year of the funds used for the activities. A grantee under the HUD-Administered Small Cities or Insular Areas CDBG programs shall apply the aggregate standards under paragraph (b)(1) of this section to all funds obligated for applicable activities from a given grant; program income obligated for applicable activities will, for these purposes, be aggregated with the most recent open grant. For any time period in which a community has no open HUD-Administered or Insular Areas grants, the aggregate standards shall be applied to all applicable activities for which program income is obligated during that period.

(ii) The grantee shall apply the aggregate standards to the number of jobs to be created/retained, or to the number of persons residing in the area served (as applicable), as determined at the time funds are obligated to activities.

(iii) Where an activity is expected both to create or retain jobs and to provide goods or services to residents of an area, the grantee may elect to count the activity under either the jobs standard or the area residents standard, but not both.

(iv) Where CDBG assistance for an activity is limited to job training and placement and/or other employment support services, the jobs assisted with CDBG funds shall be considered to be created or retained jobs for the purposes of applying the aggregate standards.

(v) Any activity subject to these guidelines which meets one or more of the following criteria may, at the grantee's option, be excluded from the aggregate standards described in paragraph (b)(1) of this section:

(A) Provides jobs exclusively for unemployed persons or participants in one or more of the following programs:

(1) Jobs Training Partnership Act (JTPA);

(2) Jobs Opportunities for Basic Skills (JOBS); or

(3) Aid to Families with Dependent Children (AFDC);

(B) Provides jobs predominantly for residents of Public and Indian Housing units;

(C) Provides jobs predominantly for homeless persons;

(D) Provides jobs predominantly for low-skilled, low- and moderate-income persons, where the business agrees to provide clear opportunities for promotion and economic advancement, such as through the provision of training;

(E) Provides jobs predominantly for persons residing within a census tract (or block numbering area) that has at least 20 percent of its residents who are in poverty;

(F) Provides assistance to business(es) that operate(s) within a census tract (or block numbering area) that has at least 20 percent of its residents who are in poverty;

(G) Stabilizes or revitalizes a neighborhood that has at least 70 percent of its residents who are low- and moderate-income;

(H) Provides assistance to a Community Development Financial Institution that serve an area that is predominantly low- and moderate-income persons;

(I) Provides assistance to a Community-Based Development Organization serving a neighborhood that has at least 70 percent of its residents who are low- and moderate-income;

(J) Provides employment opportunities that are an integral component of a project designed to promote spatial deconcentration of low- and moderate-income and minority persons;

(K) With prior HUD approval, provides substantial benefit to low-income persons through other innovative approaches;

(L) Provides services to the residents of an area pursuant to a strategy approved by HUD under the provisions of § 91.215(e) of this title;

(M) Creates or retains jobs through businesses assisted in an area pursuant to a strategy approved by HUD under the provisions of § 91.215(e) of this title.

(3) *Standards for individual activities.* Any activity subject to these guidelines which falls into one or more of the following categories will be considered by HUD to provide insufficient public benefit, and therefore may under no circumstances be assisted with CDBG funds:

(i) The amount of CDBG assistance exceeds either of the following, as applicable:

(A) $50,000 per full-time equivalent, permanent job created or retained; or

(B) $1,000 per low- and moderate-income person to which goods or services are provided by the activity.

(ii) The activity consists of or includes any of the following:

(A) General promotion of the community as a whole (as opposed to the promotion of specific areas and programs);

(B) Assistance to professional sports teams;

(C) Assistance to privately-owned recreational facilities that serve a predominantly higher-income clientele, where the recreational benefit to users or members clearly outweighs employment or other benefits to low- and moderate-income persons;

(D) Acquisition of land for which the specific proposed use has not yet been identified; and

(E) Assistance to a for-profit business while that business or any other business owned by the same person(s) or entity(ies) is the subject of unresolved findings of noncompliance relating to previous CDBG assistance provided by the recipient.

(4) *Applying the individual activity standards.* (i) Where an activity is expected both to create or retain jobs and to provide goods or services to residents of an area, it will be disqualified only if the amount of CDBG assistance exceeds both of the amounts in paragraph (b)(3)(i) of this section.

(ii) The individual activity standards in paragraph (b)(3)(i) of this section shall be applied to the number of jobs to be created or retained, or to the number of persons residing in the area served (as applicable), as determined at the time funds are obligated to activities.

(iii) Where CDBG assistance for an activity is limited to job training and placement and/or other employment support services, the jobs assisted with CDBG funds shall be considered to be created or retained jobs for the purposes of applying the individual activity standards in paragraph (b)(3)(i) of this section.

(c) *Amendments to economic development projects after review determinations.* If, after the grantee enters into a contract to provide assistance to a project, the scope or financial elements of the project change

to the extent that a significant contract amendment is appropriate, the project should be reevaluated under these and the recipient's guidelines. (This would include, for example, situations where the business requests a change in the amount or terms of assistance being provided, or an extension to the loan payment period required in the contract.) If a reevaluation of the project indicates that the financial elements and public benefit to be derived have also substantially changed, then the recipient should make appropriate adjustments in the amount, type, terms or conditions of CDBG assistance which has been offered, to reflect the impact of the substantial change. (For example, if a change in the project elements results in a substantial reduction of the total project costs, it may be appropriate for the recipient to reduce the amount of total CDBG assistance.) If the amount of CDBG assistance provided to the project is increased, the amended project must still comply with the public benefit standards under paragraph (b) of this section.

(d) *Documentation.* The grantee must maintain sufficient records to demonstrate the level of public benefit, based on the above standards, that is actually achieved upon completion of the CDBG-assisted economic development activity(ies) and how that compares to the level of such benefit anticipated when the CDBG assistance was obligated. If the grantee's actual results show a pattern of substantial variation from anticipated results, the grantee is expected to take all actions reasonably within its control to improve the accuracy of its projections. If the actual results demonstrate that the recipient has failed the public benefit standards, HUD may require the recipient to meet more stringent standards in future years as appropriate.

Subpart I—State Community Development Block Grant Program

11. Section 570.482 is amended by adding paragraphs (c), (d), (e), (f), and (g) to read as follows:

§ 570.482 Eligible activities.

* * * * *

(c) *Provision of Assistance for Microenterprise Development.* Microenterprise development activities eligible under Section 105(a)(23) of the Housing and Community Development Act of 1974 (the Act), as amended, (42 U.S.C. 5301 *et seq.*) may be carried out either through the recipient directly or through public and private organizations, agencies, and other subrecipients (including nonprofit and for-profit subrecipients).

(d) *Provision of Public Services.* The following activities shall not be subject to the restrictions on public services under Section 105(a)(8) of the Housing and Community Development Act of 1974, as amended:

(1) Support services provided under Section 105(a)(23) of the Housing and Community Development Act of 1974, as amended, and paragraph (c) of this section; and

(2) Services carried out under the provisions of Section 105(a)(15) of the Housing and Community Development Act of 1974, as amended, that are specifically designed to increase economic opportunities through job training and placement and other employment support services, including, but not limited to, peer support programs, counseling, child care, transportation, and other similar services.

(e) *Guidelines and Objectives for Evaluating Project Costs and Financial Requirements*—(1) *Applicability.* The following guidelines, also referred to as the underwriting guidelines, are provided to assist the recipient to evaluate and select activities to be carried out for economic development purposes. Specifically, these guidelines are applicable to activities that are eligible for CDBG assistance under section 105(a)(17) of the Act, economic development activities eligible under section 105(a)(14) of the Act, and activities that are part of a community economic development project eligible under section 105(a)(15) of the Act. The use of the underwriting guidelines published by HUD is not mandatory. However, states electing not to use these guidelines would be expected to ensure that the state or units of general local government conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business.

(2) *Objectives.* The underwriting guidelines are designed to provide the recipient with a framework for financially underwriting and selecting CDBG-assisted economic development projects which are financially viable and will make the most effective use of the CDBG funds. Where appropriate, HUD's underwriting guidelines recognize that different levels of review are appropriate to take into account differences in the size and scope of a proposed project, and in the case of a microenterprise or other small business to take into account the differences in the capacity and level of sophistication among businesses of differing sizes. Recipients are encouraged, when they develop their own programs and underwriting criteria, to also take these factors into account. These underwriting guidelines are published as appendix A to this part. The objectives of the underwriting guidelines are to ensure:

(i) That project costs are reasonable;

(ii) That all sources of project financing are committed;

(iii) That to the extent practicable, CDBG funds are not substituted for non-Federal financial support;

(iv) That the project is financially feasible;

(v) That to the extent practicable, the return on the owner's equity investment will not be unreasonably high; and

(vi) That to the extent practicable, CDBG funds are disbursed on a pro rata basis with other finances provided to the project.

(f) *Standards for Evaluating Public Benefit.* (1) *Purpose and Applicability.* The grantee is responsible for making sure that at least a minimum level of public benefit is obtained from the expenditure of CDBG funds under the categories of eligibility governed by these standards. The standards set forth below identify the types of public benefit that will be recognized for this purpose and the minimum level of each that must be obtained for the amount of CDBG funds used. These standards are applicable to activities that are eligible for CDBG assistance under section 105(a)(17) of the Act, economic development activities eligible under section 105(a)(14) of the Act, and activities that are part of a community economic development project eligible under section 105(a)(15) of the Act. Certain public facilities and improvements eligible under Section 105(a)(2) of the Act, which are undertaken for economic development purposes, are also subject to these standards, as specified in § 570.483(b)(4)(vi)(F)*(2).* Unlike the guidelines for project costs and financial requirements covered under paragraph (a) of this section, the use of the standards for public benefit is mandatory.

(2) *Standards for activities in the aggregate.* Activities covered by these standards must, in the aggregate, either:

(i) Create or retain at least one full-time equivalent, permanent job per $35,000 of CDBG funds used; or

(ii) Provide goods or services to residents of an area, such that the number of low- and moderate-income persons residing in the areas served by the assisted businesses amounts to at least one low- and moderate-income person per $350 of CDBG funds used.

(3) *Applying the aggregate standards.* (i) A state shall apply the aggregate

standards under paragraph (e)(2) of this section to all funds distributed for applicable activities from each annual grant. This includes the amount of the annual grant, any funds reallocated by HUD to the state, any program income distributed by the state and any guaranteed loan funds made under the provisions of subpart M of this part covered in the method of distribution in the final statement for a given annual grant year.

(ii) The grantee shall apply the aggregate standards to the number of jobs to be created/retained, or to the number of persons residing in the area served (as applicable), as determined at the time funds are obligated to activities.

(iii) Where an activity is expected both to create or retain jobs and to provide goods or services to residents of an area, the grantee may elect to count the activity under either the jobs standard or the area residents standard, but not both.

(iv) Where CDBG assistance for an activity is limited to job training and placement and/or other employment support services, the jobs assisted with CDBG funds shall be considered to be created or retained jobs for the purposes of applying the aggregate standards.

(v) Any activity subject to these standards which meets one or more of the following criteria may, at the grantee's option, be excluded from the aggregate standards described in paragraph (f)(2) of this section:

(A) Provides jobs exclusively for unemployed persons or participants in one or more of the following programs:

(1) Jobs Training Partnership Act (JTPA);

(2) Jobs Opportunities for Basic Skills (JOBS); or

(3) Aid to Families with Dependent Children (AFDC);

(B) Provides jobs predominantly for residents of Public and Indian Housing units;

(C) Provides jobs predominantly for homeless persons;

(D) Provides jobs predominantly for low-skilled, low- and moderate-income persons, where the business agrees to provide clear opportunities for promotion and economic advancement, such as through the provision of training;

(E) Provides jobs predominantly for persons residing within a census tract (or block numbering area) that has at least 20 percent of its residents who are in poverty;

(F) Provides assistance to business(es) that operate(s) within a census tract (or block numbering area) that has at least 20 percent of its residents who are in poverty;

(G) Stabilizes or revitalizes a neighborhood income that has at least 70 percent of its residents who are low- and moderate-income;

(H) Provides assistance to a Community Development Financial Institution (as defined in the Community Development Banking and Financial Institutions Act of 1994, (12 U.S.C. 4701 note)) serving an area that has at least 70 percent of its residents who are low- and moderate-income;

(I) Provides assistance to an organization eligible to carry out activities under section 105(a)(15) of the Act serving an area that has at least 70 percent of its residents who are low- and moderate-income;

(J) Provides employment opportunities that are an integral component of a project designed to promote spatial deconcentration of low- and moderate-income and minority persons;

(K) With prior HUD approval, provides substantial benefit to low-income persons through other innovative approaches.

(4) *Standards for individual activities.* Any activity subject to these standards which falls into one or more of the following categories will be considered by HUD to provide insufficient public benefit, and therefore may under no circumstances be assisted with CDBG funds:

(i) The amount of CDBG assistance exceeds either of the following, as applicable:

(A) $50,000 per full-time equivalent, permanent job created or retained; or

(B) $1,000 per low- and moderate-income person to which goods or services are provided by the activity.

(ii) The activity consists of or includes any of the following:

(A) General promotion of the community as a whole (as opposed to the promotion of specific areas and programs);

(B) Assistance to professional sports teams;

(C) Assistance to privately-owned recreational facilities that serve a predominantly higher-income clientele, where the recreational benefit to users or members clearly outweighs employment or other benefits to low- and moderate-income persons;

(D) Acquisition of land for which the specific proposed use has not yet been identified; and

(E) Assistance to a for-profit business while that business or any other business owned by the same person(s) or entity(ies) is the subject of unresolved findings of noncompliance relating to previous CDBG assistance provided by the recipient.

(5) *Applying the individual activity standards.* (i) Where an activity is expected both to create or retain jobs and to provide goods or services to residents of an area, it will be disqualified only if the amount of CDBG assistance exceeds both of the amounts in paragraph (f)(4)(i) of this section.

(ii) The individual activity tests in paragraph (f)(4)(i) of this section shall be applied to the number of jobs to be created or retained, or to the number of persons residing in the area served (as applicable), as determined at the time funds are obligated to activities.

(iii) Where CDBG assistance for an activity is limited to job training and placement and/or other employment support services, the jobs assisted with CDBG funds shall be considered to be created or retained jobs for the purposes of applying the individual activity standards in paragraph (f)(4)(i) of this section.

(6) *Documentation.* The state and its grant recipients must maintain sufficient records to demonstrate the level of public benefit, based on the above standards, that is actually achieved upon completion of the CDBG-assisted economic development activity(ies) and how that compares to the level of such benefit anticipated when the CDBG assistance was obligated. If a state grant recipient's actual results show a pattern of substantial variation from anticipated results, the state and its recipient are expected to take those actions reasonably within their respective control to improve the accuracy of the projections. If the actual results demonstrate that the state has failed the public benefit standards, HUD may require the state to meet more stringent standards in future years as appropriate.

(g) *Amendments to economic development projects after review determinations.* If, after the grantee enters into a contract to provide assistance to a project, the scope or financial elements of the project change to the extent that a significant contract amendment is appropriate, the project should be reevaluated under these and the recipient's guidelines. (This would include, for example, situations where the business requests a change in the amount or terms of assistance being provided, or an extension to the loan payment period required in the contract.) If a reevaluation of the project indicates that the financial elements and public benefit to be derived have also substantially changed, then the recipient should make appropriate adjustments in the amount, type, terms

or conditions of CDBG assistance which has been offered, to reflect the impact of the substantial change. (For example, if a change in the project elements results in a substantial reduction of the total project costs, it may be appropriate for the recipient to reduce the amount of total CDBG assistance.) If the amount of CDBG assistance provided to the project is increased, the amended project must still comply with the public benefit standards under paragraph (f) of this section.

12. Section 570.483 is amended by:

a. Revising the section heading;

b. Adding a new paragraph (b)(1)(iv):

c. Revising paragraph (b)(2)(i)(C), and adding new paragraphs (b)(2)(iv) and (b)(2)(v);

d. Revising paragraph (b)(3) introductory text;

e. Redesignating paragraph (b)(4)(iv) as (b)(4)(vi), and by adding new paragraphs (b)(4)(iv) and (v);

f. Revising newly designated paragraph (b)(4)(vi)(B);

g. Redesignating newly designated paragraph (b)(4)(vi)(c) as paragraph (b)(4)(vi)(F) and revising it;

h. Adding new paragraphs (b)(4)(vi)(C), (D) and (E); and

i. Adding new paragraphs (e)(4) and (5), to read as follows:

§ 570.483 Criteria for national objectives.

* * * * *

(b) * * *

(1) * * *

(iv) Activities meeting the requirements of paragraph (e)(4)(i) of this section may also be considered to qualify under this paragraph (b).

(2) * * *

(i) * * *

(C) Activities where the benefit to low- and moderate-income persons to be considered is the creation or retention of jobs, except as provided in paragraph (b)(2)(v) of this section.

* * * * *

(iv) A microenterprise assistance activity (carried out in accordance with the provisions of Section 105(a)(23) of the Act or § 570.482(c) and limited to microenterprises) with respect to those owners of microenterprises and persons developing microenterprises assisted under the activity who are low- and moderate-income persons. For purposes of this paragraph, persons determined to be low and moderate income may be presumed to continue to qualify as such for up to a three-year period.

(v) An activity designed to provide job training and placement and/or other employment support services, including, but not limited to, peer support programs, counseling, child care, transportation, and other similar services, in which the percentage of low- and moderate-income persons assisted is less than 51 percent may qualify under this paragraph in the following limited circumstances:

(A) In such cases where such training or provision of supportive services is an integrally-related component of a larger project, the only use of CDBG assistance for the project is to provide the job training and/or supportive services; and

(B) The proportion of the total cost of the project borne by CDBG funds is no greater than the proportion of the total number of persons assisted who are low or moderate income.

(3) *Housing activities.* An eligible activity carried out for the purpose of providing or improving permanent residential structures which, upon completion, will be occupied by low- and moderate-income households. This would include, but not necessarily be limited to, the acquisition or rehabilitation of property, conversion of non-residential structures, and new housing construction. If the structure contains two dwelling units, at least one must be so occupied, and if the structure contains more than two dwelling units, at least 51 percent of the units must be so occupied. Where two or more rental buildings being assisted are or will be located on the same or contiguous properties, and the buildings will be under common ownership and management, the grouped buildings may be considered for this purpose as a single structure. Where housing activities being assisted meet the requirements of paragraph (e)(4)(ii) of this section, all such housing may also be considered for this purpose as a single structure. For rental housing, occupancy by low and moderate income households must be at affordable rents to qualify under this criterion. The recipient shall adopt and make public its standards for determining ''affordable rents'' for this purpose. The following shall also qualify under this criterion:

* * * * *

(4) * * *

(iv) For purposes of determining whether a job is held by or made available to a low- or moderate-income person, the person may be presumed to be a low- or moderate-income person if:

(A) He/she resides within a census tract (or block numbering area) that either:

(*1*) Meets the requirements of paragraph (b)(4)(v) of this section; or

(*2*) Has at least 70 percent of its residents who are low- and moderate-income persons; or

(B) The assisted business is located within a census tract (or block numbering area) that meets the requirements of paragraph (b)(4)(v) of this section and the job under consideration is to be located within that census tract.

(v) A census tract (or block numbering area) qualifies for the presumptions permitted under paragraphs (b)(4)(iv)(A)(*1*) and (B) of this section if it is either part of a Federally-designated Empowerment Zone or Enterprise Community or meets the following criteria:

(A) It has a poverty rate of at least 20 percent as determined by the most recently available decennial census information;

(B) It does not include any portion of a central business district, as this term is used in the most recent Census of Retail Trade, unless the tract has a poverty rate of at least 30 percent as determined by the most recently available decennial census information; and

(C) It evidences pervasive poverty and general distress by meeting at least one of the following standards:

(*1*) All block groups in the census tract have poverty rates of at least 20 percent;

(*2*) The specific activity being undertaken is located in a block group that has a poverty rate of at least 20 percent; or

(*3*) Upon the written request of the recipient, HUD determines that the census tract exhibits other objectively determinable signs of general distress such as high incidence of crime, narcotics use, homelessness, abandoned housing, and deteriorated infrastructure or substantial population decline.

(vi) * * *

(B) Where CDBG funds are used to pay for the staff and overhead costs of a subrecipient specified in section 105(a)(15) of the Act making loans to businesses exclusively from non-CDBG funds, this requirement may be met by aggregating the jobs created by all of the businesses receiving loans during any one-year period.

(C) Where CDBG funds are used by a recipient or subrecipient to provide technical assistance to businesses, this requirement may be met by aggregating the jobs created or retained by all of the businesses receiving technical assistance during any one-year period.

(D) Where CDBG funds are used for activities meeting the criteria listed at § 570.482(f)(3)(v), this requirement may be met by aggregating the jobs created or retained by all businesses for which CDBG assistance is obligated for such activities during any one-year period, except as provided at paragraph (e)(5) of this section.

(E) Where CDBG funds are used by a Community Development Financial Institution to carry out activities for the purpose of creating or retaining jobs, this requirement may be met by aggregating the jobs created or retained by all businesses for which CDBG assistance is obligated for such activities during any one-year period, except as provided at paragraph (e)(5) of this section.

(F) Where CDBG funds are used for public facilities or improvements which will result in the creation or retention of jobs by more than one business, this requirement may be met by aggregating the jobs created or retained by all such businesses as a result of the public facility or improvement.

(*1*) Where the public facility or improvement is undertaken principally for the benefit of one or more particular businesses, but where other businesses might also benefit from the assisted activity, the requirement may be met by aggregating only the jobs created or retained by those businesses for which the facility/improvement is principally undertaken, provided that the cost (in CDBG funds) for the facility/improvement is less than $10,000 per permanent full-time equivalent job to be created or retained by those businesses.

(*2*) In any case where the cost per job to be created or retained (as determined under paragraph (b)(4)(iii)(C)(*1*) of this section) is $10,000 or more, the requirement must be met by aggregating the jobs created or retained as a result of the public facility or improvement by all businesses in the service area of the facility/improvement. This aggregation must include businesses which, as a result of the public facility/improvement, locate or expand in the service area of the public facility/improvement between the date the state awards the CDBG funds to the recipient and the date one year after the physical completion of the public facility/improvement. In addition, the assisted activity must comply with the public benefit standards at § 570.482(e).

* * * * *

(e) * * *

(4) Where CDBG-assisted activities are carried out by a Community Development Financial Institution whose charter limits its investment area to a primarily residential area consisting of at least 51 percent low- and moderate-income persons, the unit of general local government may also elect the following options:

(i) Activities carried out by the Community Development Financial Institution for the purpose of creating or retaining jobs may, at the option of the unit of general local government, be considered to meet the requirements of this paragraph under the criteria at paragraph (b)(1)(iv) of this section in lieu of the criteria at paragraph (b)(4) of this section; and

(ii) All housing activities for which the Community Development Financial Institution obligates CDBG assistance during any one-year period may be considered to be a single structure for purposes of applying the criteria at paragraph (b)(3) of this section.

(5) Where an activity meeting the criteria at § 570.482(f)(3)(v) also meets the requirements at paragraph (e)(4)(i) of this section, the unit of general local government may elect to qualify the activity under either the area benefit criteria at paragraph (b)(1)(iv) of this section or the job aggregation criteria at paragraph (b)(4)(vi)(D) of this section, but not both. Where an activity may meet the job aggregation criteria at both paragraphs (b)(4)(vi) (D) and (E) of this section, the unit of general local government may elect to qualify the activity under either criterion, but not both.

* * * * *

13. Section 570.489 is amended by:

a. Revising paragraph (e)(1) introductory text;

b. Redesignating paragraph (e)(2) as paragraph (e)(3); and

c. Adding a new paragraph (e)(2), to read as follows:

§ 570.489 Program administrative requirements.

* * * * *

(e) *Program income.* (1) For the purposes of this subpart, ''program income'' is defined as gross income received by a state, a unit of general local government or a subrecipient of a unit of general local government that was generated from the use of CDBG funds, except as provided in paragraph (e)(2) of this section. When income is generated by an activity that is only partially assisted with CDBG funds, the income shall be prorated to reflect the percentage of CDBG funds used (e.g., a single loan supported by CDBG funds and other funds; a single parcel of land purchased with CDBG funds and other funds). Program income includes, but is not limited to, the following:

* * * * *

(2) ''Program income'' does not include the following:

(i) The total amount of funds which is less than $25,000 received in a single year that is retained by a unit of general local government and its subrecipients;

(ii) Amounts generated by activities eligible under section 105(a)(15) of the Act and carried out by an entity under the authority of section 105(a)(15) of the Act;

(iii) Amounts generated by activities that are financed by a loan guaranteed under Section 108 of the Act and meet one or more of the public benefit criteria specified at § 570.482(f)(3)(v) or are carried out in conjunction with a grant under Section 108(q) of the Act in an area determined by HUD to meet the eligibility requirements for designation as an Urban Empowerment Zone pursuant to 24 CFR part 597, subpart B. Such exclusion shall not apply if CDBG funds are used to repay the guaranteed loan. When such a guaranteed loan is partially repaid with CDBG funds, the amount generated shall be prorated to reflect the percentage of CDBG funds used. Amounts generated by activities financed with loans guaranteed under Section 108 of the Act which are not defined as program income shall be treated as miscellaneous revenue and shall not be subject to any of the requirements of this part. However, such treatment shall not affect the right of the Secretary to require the Section 108 borrower to pledge such amounts as security for the guaranteed loan. The determination whether such amounts shall constitute program income shall be governed by the provisions of the contract required at § 570.705(b)(1).

* * * * *

Subpart J—Grant Administration

14. Section 570.500 is amended by revising paragraph (a) introductory text; by adding a new paragraph (a)(4); and by revising paragraph (c); to read as follows:

§ 570.500 Definitions.

* * * * *

(a) *Program income* means gross income received by the recipient or a subrecipient directly generated from the use of CDBG funds, except as provided in paragraph (a)(4) of this section.

* * * * *

(4) Program income does not include:

(i) Any income received in a single program year by the recipient and all its subrecipients if the total amount of such income does not exceed $25,000; and

(ii) Amounts generated by activities that are financed by a loan guaranteed under Section 108 of the Act and meet one or more of the public benefit criteria specified at § 570.209(b)(2)(v) or are carried out in conjunction with a grant under Section 108(q) in an area determined by HUD to meet the eligibility requirements for designation as an Urban Empowerment Zone pursuant to 24 CFR part 597, subpart B. Such exclusion shall not apply if CDBG

funds are used to repay the guaranteed loan. When such a guaranteed loan is partially repaid with CDBG funds, the amount generated shall be prorated to reflect the percentage of CDBG funds used. Amounts generated by activities financed with loans guaranteed under Section 108 which are not defined as program income shall be treated as miscellaneous revenue and shall not be subject to any of the requirements of this Part. However, such treatment shall not affect the right of the Secretary to require the Section 108 borrower to pledge such amounts as security for the guaranteed loan. The determination whether such amounts shall constitute program income shall be governed by the provisions of the contract required at § 570.705(b)(1).

* * * * *

(c) *Subrecipient* means a public or private nonprofit agency, authority or organization, or a for-profit entity authorized under § 570.201(o), receiving CDBG funds from the recipient to undertake activities eligible for such assistance under Subpart C of this part. The term excludes an entity receiving CDBG funds from the recipient under the authority of § 570.204. The term includes a public agency designated by a metropolitan city or urban county to receive a loan guarantee under Subpart M of this part, but does not include contractors providing supplies, equipment, construction or services subject to the procurement requirements in 24 CFR 85.36 or in Attachment O of OMB Circular A–110, as applicable.

15. Section 570.506 is amended by revising paragraph (b) introductory text; by removing the semicolon at the end of paragraph (b)(2)(iii) and adding a period in its place; by redesignating paragraphs (b)(7) through (b)(11) as paragraphs (b)(8) through (b)(12), respectively; by adding a new paragraph (b)(7); and by revising paragraph (c), to read as follows:

§ 570.506 Records to be maintained.

* * * * *

(b) Records demonstrating that each activity undertaken meets one of the criteria set forth in § 570.208. (Where information on income by family size is required, the recipient may substitute evidence establishing that the person assisted qualifies under another program having income qualification criteria at least as restrictive as that used in the definitions of ''low and moderate income person'' and ''low and moderate income household'' (as applicable) at § 570.3, such as Job Training Partnership Act (JTPA) and welfare programs; or the recipient may substitute evidence that the assisted person is homeless; or the recipient may substitute a copy of a verifiable certification from the assisted person that his or her family income does not exceed the applicable income limit established in accordance with § 570.3; or the recipient may substitute a notice that the assisted person is a referral from a state, county or local employment agency or other entity that agrees to refer individuals it determines to be low and moderate income persons based on HUD's criteria and agrees to maintain documentation supporting these determinations.) Such records shall include the following information:

* * * * *

(7) For purposes of documenting, pursuant to paragraphs (b)(5)(i)(B), (b)(5)(ii)(C), (b)(6)(iii) or (b)(6)(v) of this section, that the person for whom a job was either filled by or made available to a low- or moderate-income person based upon the census tract where the person resides or in which the business is located, the recipient, in lieu of maintaining records showing the person's family size and income, may substitute records showing either the person's address at the time the determination of income status was made or the address of the business providing the job, as applicable, the census tract in which that address was located, the percent of persons residing in that tract who either are in poverty or who are low- and moderate-income, as applicable, the data source used for determining the percentage, and a description of the pervasive poverty and general distress in the census tract in sufficient detail to demonstrate how the census tract met the criteria in § 570.208(a)(4)(v), as applicable.

* * * * *

(c) Records which demonstrate that the recipient has made the determinations required as a condition of eligibility of certain activities, as prescribed in §§ 570.201(f), 570.201(i), 570.202(b)(3), 570.203(b), 570.204(a), 570.206(f), and 570.209.

* * * * *

16. Appendix A is added to part 570 to read as follows:

Appendix A to Part 570—Guidelines and Objectives for Evaluating Project Costs and Financial Requirements

I. *Guidelines and Objectives for Evaluating Project Costs and Financial Requirements.* HUD has developed the following guidelines that are designed to provide the recipient with a framework for financially underwriting and selecting CDBG-assisted economic development projects which are financially viable and will make the most effective use of the CDBG funds. *The use of these underwriting guidelines as published by HUD is not mandatory.* However, grantees electing not to use these underwriting guidelines would be expected to conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business. States electing not to use these underwriting guidelines would be expected to ensure that the state or units of general local government conduct basic financial underwriting prior to the provision of CDBG financial assistance to a for-profit business.

II. Where appropriate, HUD's underwriting guidelines recognize that different levels of review are appropriate to take into account differences in the size and scope of a proposed project, and in the case of a microenterprise or other small business to take into account the differences in the capacity and level of sophistication among businesses of differing sizes.

III. Recipients are encouraged, when they develop their own programs and underwriting criteria, to also take these factors into account. For example, a recipient administering a program providing only technical assistance to small businesses might choose to apply underwriting guidelines to the technical assistance program as a whole, rather than to each instance of assistance to a business. Given the nature and dollar value of such a program, a recipient might choose to limit its evaluation to factors such as the extent of need for this type of assistance by the target group of businesses and the extent to which this type of assistance is already available.

IV. The objectives of the underwriting guidelines are to ensure:

(1) that project costs are reasonable;

(2) that all sources of project financing are committed;

(3) that to the extent practicable, CDBG funds are not substituted for non-Federal financial support;

(4) that the project is financially feasible;

(5) that to the extent practicable, the return on the owner's equity investment will not be unreasonably high; and

(6) that to the extent practicable, CDBG funds are disbursed on a pro rata basis with other finances provided to the project.

i. Project costs are reasonable. i. Reviewing costs for reasonableness is important. It will help the recipient avoid providing either too much or too little CDBG assistance for the proposed project. Therefore, it is suggested that the grantee obtain a breakdown of all project costs and that each cost element making up the project be reviewed for reasonableness. The amount of time and resources the recipient expends evaluating the reasonableness of a cost element should be commensurate with its cost. For example, it would be appropriate for an experienced reviewer looking at a cost element of less than $10,000 to judge the reasonableness of that cost based upon his or her knowledge and common sense. For a cost element in excess of $10,000, it would be more appropriate for the reviewer to compare the cost element with a third-party, fair-market price quotation for that cost element. Third-party price quotations may also be used by a reviewer to help determine the reasonableness of cost elements below $10,000 when the reviewer evaluates projects

infrequently or if the reviewer is less experienced in cost estimations. If a recipient does not use third-party price quotations to verify cost elements, then the recipient would need to conduct its own cost analysis using appropriate cost estimating manuals or services.

ii. The recipient should pay particular attention to any cost element of the project that will be carried out through a non-arms-length transaction. A non-arms-length transaction occurs when the entity implementing the CDBG assisted activity procures goods or services from itself or from another party with whom there is a financial interest or family relationship. If abused, non-arms-length transactions misrepresent the true cost of the project.

2. *Commitment of all project sources of financing.* The recipient should review all projected sources of financing necessary to carry out the economic development project. This is to ensure that time and effort is not wasted on assessing a proposal that is not able to proceed. To the extent practicable, prior to the commitment of CDBG funds to the project, the recipient should verify that: sufficient sources of funds have been identified to finance the project; all participating parties providing those funds have affirmed their intention to make the funds available; and the participating parties have the financial capacity to provide the funds.

3. *Avoid substitution of CDBG funds for non-Federal financial support.* i. The recipient should review the economic development project to ensure that, to the extent practicable, CDBG funds will not be used to substantially reduce the amount of non-Federal financial support for the activity. This will help the recipient to make the most efficient use of its CDBG funds for economic development. To reach this determination, the recipient's reviewer would conduct a financial underwriting analysis of the project, including reviews of appropriate projections of revenues, expenses, debt service and returns on equity investments in the project. The extent of this review should be appropriate for the size and complexity of the project and should use industry standards for similar projects, taking into account the unique factors of the project such as risk and location.

ii. Because of the high cost of underwriting and processing loans, many private financial lenders do not finance commercial projects that are less than $100,000. A recipient should familiarize itself with the lending practices of the financial institutions in its community. If the project's total cost is one that would normally fall within the range that financial institutions participate, then the recipient should normally determine the following:

A. *Private debt financing*—whether or not the participating private, for-profit business (or other entity having an equity interest) has applied for private debt financing from a commercial lending institution and whether that institution has completed all of its financial underwriting and loan approval actions resulting in either a firm commitment of its funds or a decision not to participate in the project; and

B. *Equity participation*—whether or not the degree of equity participation is reasonable given general industry standards for rates of return on equity for similar projects with similar risks and given the financial capacity of the entrepreneur(s) to make additional financial investments.

iii. If the recipient is assisting a microenterprise owned by a low- or moderate-income person(s), in conducting its review under this paragraph, the recipient might only need to determine that non-Federal sources of financing are not available (at terms appropriate for such financing) in the community to serve the low- or moderate-income entrepreneur.

4. *Financial feasibility of the project.* i. The public benefit a grantee expects to derive from the CDBG assisted project (the subject of separate regulatory standards) will not materialize if the project is not financially feasible. To determine if there is a reasonable chance for the project's success, the recipient should evaluate the financial viability of the project. A project would be considered financially viable if all of the assumptions about the project's market share, sales levels, growth potential, projections of revenue, project expenses and debt service (including repayment of the CDBG assistance if appropriate) were determined to be realistic and met the project's break-even point (which is generally the point at which all revenues are equal to all expenses). Generally speaking, an economic development project that does not reach this break-even point over time is not financially feasible. The following should be noted in this regard:

A. some projects make provisions for a negative cash flow in the early years of the project while space is being leased up or sales volume built up, but the project's projections should take these factors into account and provide sources of financing for such negative cash flow; and

B. it is expected that a financially viable project will also project sufficient revenues to provide a reasonable return on equity investment. The recipient should carefully examine any project that is not economically able to provide a reasonable return on equity investment. Under such circumstances, a business may be overstating its real equity investment (actual costs of the project may be overstated as well), or it may be overstating some of the project's operating expenses in the expectation that the difference will be taken out as profits, or the business may be overly pessimistic in its market share and revenue projections and has downplayed its profits.

ii. In addition to the financial underwriting reviews carried out earlier, the recipient should evaluate the experience and capacity of the assisted business owners to manage an assisted business to achieve the projections. Based upon its analysis of these factors, the recipient should identify those elements, if any, that pose the greatest risks contributing to the project's lack of financial feasibility.

5. *Return on equity investment.* To the extent practicable, the CDBG assisted activity should provide not more than a reasonable return on investment to the owner of the assisted activity. This will help ensure that the grantee is able to maximize the use of its CDBG funds for its economic development objectives. However, care should also be taken to avoid the situation where the owner is likely to receive too small a return on his/her investment, so that his/her motivation remains high to pursue the business with vigor. The amount, type and terms of the CDBG assistance should be adjusted to allow the owner a reasonable return on his/her investment given industry rates of return for that investment, local conditions and the risk of the project.

6. *Disbursement of CDBG funds on a pro rata basis.* To the extent practicable, CDBG funds used to finance economic development activities should be disbursed on a pro rata basis with other funding sources. Recipients should be guided by the principle of not placing CDBG funds at significantly greater risk than non-CDBG funds. This will help avoid the situation where it is learned that a problem has developed that will block the completion of the project, even though all or most of the CDBG funds going in to the project have already been expended. When this happens, a recipient may be put in a position of having to provide additional financing to complete the project or watch the potential loss of its funds if the project is not able to be completed. When the recipient determines that it is not practicable to disburse CDBG funds on a pro rata basis, the recipient should consider taking other steps to safeguard CDBG funds in the event of a default, such as insisting on securitizing assets of the project.

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